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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

MARYLAND HIGHER EDUCATION LOAN CORPORATION,
Petitioner,

v.

LAURO F. CAVAZOS, SECRETARY OF THE UNITED STATES DEPARTMENT OF EDUCATION, *et al.*,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Do the 1987 amendments to the Higher Education Act of 1965, which authorize the Secretary of Education to expropriate $250 million in "excess cash reserves" held by state and private student loan guaranty agencies, violate the Fifth Amendment's Takings Clause?

LIST OF PARTIES

The parties are the Maryland Higher Education Loan Corporation (appellee below and petitioner here), the United States Department of Education, and its Secretary, Lauro F. Cavazos (appellants below and respondents here). The South Carolina State Education Assistance Authority, the State of North Carolina and the North Carolina State Education Assistance Authority were also parties to the consolidated proceeding below, and the Virginia State Education Assistance Authority and the National Council of Higher Education Loan Programs, Inc. participated in the proceeding below as *amici curiae*.

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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PETITION FOR WRIT OF CERTIORARI

Over Maryland's constitutional objections, the United States Court of Appeals for the Fourth Circuit upheld the Secretary of Education's "taking" of $10.8 million. Petitioner respectfully seeks review of that judgment.

OPINIONS BELOW

The March 7, 1990 opinion of the Court of Appeals for the Fourth Circuit is reported at 897 F.2d 1272 and is reprinted in the appendix to this petition ("App.") at App. 1a-11a. The June 12, 1989 opinion

of the United States District Court for the District of Maryland is unreported and is reprinted at App. 15a-19a. The district court's decision incorporated by reference and attached the May 31, 1989 opinion of the United States District Court for the District of South Carolina in *South Carolina State Education Assistance Authority v. Cavazos*, which is reported at 716 F. Supp. 886 and is reprinted at App. 20a-37a.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was entered on March 7, 1990, and on March 28, 1990, that court denied petitioner's request for rehearing and suggestion for rehearing in banc. (App. at 12a-14a.) This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) and § 2101(c).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The constitutional, statutory and regulatory provisions involved in this case are the Fifth Amendment to the United States Constitution; section 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36, formerly codified at 20 U.S.C. § 1072(e); 20 U.S.C. § 1078(c)(1)(A) (Supp. 1986); and 34 C.F.R. § 682.410(a), all of which are reproduced beginning at App. 38a.

STATEMENT OF THE CASE

In 1987, as part of its effort to comply with the budget-cutting requirements of the Gramm-Rudman-Hollings Act, Congress amended the Higher Education Act of 1965 to abrogate pre-existing contract rights with the states and mandate the transfer to the federal treasury of $250 million from state and

private student loan guaranty agencies across the country. This confiscatory action, which cost the State of Maryland approximately $10.8 million, is challenged in this case.

A. The History And Operation Of The Guaranteed Student Loan Program.

Petitioner Maryland Higher Education Loan Corporation ("Petitioner" or "Maryland") was created in 1963 by Maryland statute as a nonprofit state corporation to provide student loans, guarantees, and other services to assist Maryland residents in financing post-secondary education. *See* 1963 Laws of Maryland; ch. 589; Md. Educ. Code Ann. §§ 18-1002, 1003 (1989). Over the years, approximately $11.5 million in state funds have been appropriated to petitioner for this purpose.

The Higher Education Act of 1965, as amended (codified in part at 20 U.S.C. §§ 1071 to 1087-2) (the "Act") established a nationwide guaranteed student loan program to finance the costs of higher education. The Act has been implemented primarily through various contracts between state and private guaranty agencies and the United States Department of Education and its Secretary (the "Secretary"). To be an eligible contracting party, a guaranty agency must operate its own guaranteed student loan program which meets federal requirements. *See* 20 U.S.C. § 1078(b)(1).

The Secretary's approval of a guaranty agency's program is embodied in a "participation agreement" between the agency and the Secretary, thereby making student loans eligible for interest subsidies paid directly to lenders. Additionally, the Secretary's ap-

proval means that a participating guaranty agency is eligible for administrative cost allowances (which partially reimburse the agency for its administrative expenses) and for reinsurance payments (which reimburse it for monies paid by the agency to lenders for defaulted loans). *See generally* 34 C.F.R. § 682.400.

The Act authorizes the Secretary to enter into reinsurance contracts with guaranty agencies, such as petitioner, and for a fee to reimburse each agency for all or a portion of claims that the agency pays to lenders of defaulted loans guaranteed by the agency. 20 U.S.C. § 1078(c). Under this program, lenders advance funds to students; Maryland is the guarantor of 100% of the loan; and the Secretary reinsures all or part of the loan for the benefit of Maryland, depending on its default rate. *Id.* In the event of default, a lender's sole right of recovery is against Maryland, not the Secretary.

Since 1968, when reinsurance was first authorized, the Act has obligated the Secretary to make reinsurance payments to guaranty agencies. Prior to the enactment of the legislation giving rise to this litigation, the Act provided as follows:

> *The guaranty agency shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement according to the provisions of this subsection.* Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in

> paragraph (7) [relating to default rates and reimbursement rates for new agencies], the amount to be paid a guaranty agency shall be equal to 100 percent of the amount expended by it in discharge of its loan insurance obligation incurred under its insurance program. . . .

20 U.S.C. § 1078(c)(1)(A) (1986 Supp.) (emphasis added) (amended 1987).

Maryland entered into agreements with the Secretary which obligated him to pay up to 100% of the amounts expended by Maryland to discharge its guaranty obligations. (App. at 5a; 17a-18a.) In exchange for the Secretary's obligation to reimburse the State, Maryland actively implemented and administered the Guaranteed Student Loan Program and, more recently, has paid a reinsurance fee to the Secretary based on the principal amount of its new reinsured loans. *See* 20 U.S.C. § 1078(c)(9). As of December 22, 1987, Maryland had guaranteed to lenders, and the Secretary had reinsured, $1.02 billion in student loans.

B. The 1987 Amendments To The Act.

Effective December 22, 1987, § 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 ("1987 Amendments") (App. at 40a-44a) required the Secretary to determine the maximum allowable cash reserves for each guaranty agency, and authorized the Secretary to direct any agency with "excess cash reserves" to transfer such reserves to the Secretary. 20 U.S.C. § 1072(e). The new law also changed § 1078(c)(1)(A), which had provided that guaranty agencies "shall be deemed to have a contractual right against the United States,

during the life of [any insured] loan, to receive reimbursement", to provide instead that guaranty agencies "shall, *subject to section 1072(e)* [the "excess cash reserves" transfer provision] of this title, be deemed to have a contractual right against the United States. . . . " (Emphasis added.)

Thus, while the Act had previously granted guaranty agencies enforceable contractual reimbursement rights, the 1987 Amendments effectively extinguished those rights by making reimbursement contingent on the agency's having paid its "excess cash reserves" to the Secretary. This legislation was designed to help Congress meet the Gramm-Rudman-Hollings budget guidelines by directing the Secretary of Education to appropriate "$250 million from guaranty agencies to help finance federal expenditures under the GSL Program." *Delaware v. Cavazos*, 723 F. Supp. 234, 237 (D. Del. 1989) (footnote omitted).

In February, 1988, the Secretary notified Maryland that it was required to pay $10.8 million in "excess cash reserves" to the Secretary. (App. at 7a.) Maryland refused to comply with this directive, and the Secretary has since withheld the entire "excess cash reserve" amount ($10.8 million) by refusing to pay Maryland's otherwise unquestionably eligible reimbursement claims. (App. at 7a; 17a-19a.)

C. Proceedings Below.

Promptly after the Secretary first withheld reimbursement payments pursuant to the 1987 Amendments, Maryland filed this suit. The United States District Court for the District of Maryland (Hon. Frederic N. Smalkin, Judge) declared that because Maryland has an indefeasible reimbursement right

against the Secretary, 20 U.S.C. § 1072(e) violates the Fifth Amendment. (App. at 18a-19a.) The court squarely held that Maryland's reserve funds "are the property of the plaintiff, and * * * the federal government cannot simply take the cash reserves away from the plaintiff, especially through the vehicle of reneging on its obligation to reimburse for losses experienced by plaintiff in connection with previously guaranteed loans." (App. at 19a.)

The Secretary appealed, and this action was consolidated with two similar challenges to the constitutionality of the 1987 Amendments brought by the States of South and North Carolina. In *South Carolina State Education Assistance Authority v. Cavazos*, 716 F. Supp. 886 (D.S.C. 1989), the court struck down the constitutionality of § 1072(e), and in *North Carolina v. United States*, 725 F. Supp. 874 (E.D.N.C. 1989), the court upheld the constitutionality of § 1072(e). On March 7, 1990, the Fourth Circuit Court of Appeals upheld the constitutionality of § 1072(e), thus reversing the Maryland and South Carolina decisions and affirming the North Carolina decision. (App. at 11a.)

REASONS FOR GRANTING REVIEW

SUMMARY

This case presents the important question of whether Congress can reduce the federal deficit by taking property held by the states merely because a program is regulated by federal law. Maryland's position here and that of states in similar litigation pending throughout the country is that the Fifth Amendment does not permit Congress to pursue the admittedly worthy objective of reducing the enormous

federal deficit by confiscating private property. The decision below should be reviewed because it constitutes an unprecedented expansion of Congress' power to add to the federal treasury at the expense of the rights of the states to hold property and plan their affairs in justified reliance on express statutory and contractual obligations.

The Fourth Circuit's finding that § 1072(e) is constitutional conflicts with two lines of decisions in this Court. First, this Court has held that even extensive regulation of private property does not alter ownership rights in that property; and second, this Court has held that Congress' power to amend legislation does not authorize it to abrogate legally enforceable rights.

The legislation at issue in this case is being challenged by twenty-six guaranty agencies in federal courts throughout the nation, and has been declared unconstitutional by three district courts. Given the attractiveness of attempting to reduce the federal deficit by appropriating other people's money, rather than undertaking the constitutional but politically more painful tasks of cutting expenditures or raising taxes, *and* the legal uncertainty of the approach employed by Congress here, this Court should review the constitutionality of § 1072(e). Further, because the federal and state governments are involved jointly in a multitude of contractual, grant, and insurance programs, both Congress and the states need to know whether the constitutional guarantee that property cannot be taken without just compensation invalidates the deficit-reduction action challenged here.

THIS CASE PRESENTS THE IMPORTANT CONSTITUTIONAL QUESTION OF WHETHER STATE AND PRIVATE STUDENT LOAN GUARANTY AGENCIES HAVE FIFTH AMENDMENT-PROTECTED PROPERTY INTERESTS IN THEIR CONTRACT RIGHTS AND STUDENT LOAN RESERVE FUNDS.

The Fifth Amendment's Takings Clause prohibits the federal government from appropriating property that belongs to another. *See, e.g., Lynch v. United States*, 292 U.S. 571, 579 (1934). Therefore, the core issue in this case is whether Maryland's reserve funds are "private property" within the meaning of the Takings Clause.

The Fourth Circuit stated that "[t]he nature of the loan program militates against a finding that the state agencies [Maryland, North Carolina, and South Carolina] possessed [any] indicia of private ownership" in the reserve funds they hold. (App. at 9a.) It reasoned that because Maryland's reserves are extensively controlled by federal regulations, Maryland's " 'property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, [and] it loses its character as "private" property and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment.' " (App. at 9a) (quoting *North Carolina v. United States*, 725 F. Supp. 874, 876-77 (E.D.N.C. 1989)).

This analysis is severely flawed and defines "private property" in an unprecedented and unconstitutional fashion. First, as this Court has held, even extensive regulation of property does not change its essential private character, nor does it extinguish the rights of ownership. *See, e.g., Penn Central Trans-*

portation Co. v. New York City, 438 U.S. 104 (1978). Similarly, federal regulation does not convert private property into the property of the federal government. *See Forsham v. Harris*, 445 U.S. 169, 180-81 (1980); *United States v. Orleans*, 425 U.S. 807, 816 (1976); *see also Commissioner of Internal Revenue v. Lincoln Savings and Loan Association*, 403 U.S. 345, 355 (1971) (entities required by federal law to maintain reserve funds subject to extensive federal control nevertheless have "a distinct and recognized property interest" in those reserves).[1] And finally, contrary to the Fourth Circuit's suggestion (App. at 9a), the Fifth Amendment protects property used for public purposes by state and local governments no less than it protects other private property. *See United States v. 50 Acres of Land*, 469 U.S. 24, 31 (1984); *United States v. 564.54 Acres of Land*, 441 U.S. 506, 507 (1979).

In this case, there is no dispute that Maryland's reserves have always been in Maryland's possession and were derived entirely from non-federal sources.[2]

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[1] Additionally, the regulation at issue, 34 C.F.R. § 682.410(a), did not even come into existence until 1986, over 23 years after petitioner was created and had been accumulating and using its reserves to administer its student loan program. To hold, as the court below did, that the regulation "prevent[s] any of the guaranty agencies from acquiring an ownership interest in its reserve fund" (App. at 10a), is to concede that prior to 1986 such an ownership interest existed, which thus must have been taken by the 1986 regulation.

[2] Petitioner's cash reserves and operating funds have been deposited at all times in the State Treasury of Maryland. Indeed, because respondents have never had any legal or physical control over petitioner's reserves, they could only collect petitioner's "excess cash reserves" by withholding reimbursement payments

Thus, Maryland has exclusive rights to possession, use, and disposition of its reserve funds. These are the principal indicia of private property. *See Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984). Indeed, *before* the 1987 Amendments were enacted, Congress confirmed the private nature of the guaranty agencies and their reserves when it provided that the guaranty agencies "shall be deemed to have a contractual right against the United States, during the life of [any insured] loan, to receive reimbursement" if the loan defaults and is paid off by the agency, *see* 20 U.S.C. § 1078(c)(1)(A) (1986 Supp.), and provided further that these agencies have the right to sue the Secretary if the Secretary fails to comply with his reimbursement obligations. *See* 20 U.S.C. § 1082(a)(2).[3]

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due and payable to petitioner. Moreover, Maryland proved below that its reserves came exclusively from non-federal sources such as insurance premiums paid by financial institutions whose loans were guaranteed by Maryland, state appropriations, investment earnings, and a percentage of collected defaulted loans that were previously paid off by Maryland. Maryland received payments from the Secretary, but these funds only partially reimbursed Maryland for expenditures it made in the administration of its student loan program including payments made on defaulted student loans.

[3] *See also* H. R. Rep. No. 383, 99th Cong., 2nd Sess. *reprinted in* 1986 U.S. Code Cong. & Ad. News 2572, 2610 ("agencies have a contractual right for such [reimbursement] payments and may sue to enforce such right"). Congress clarified this contractual right in 1986 in recognition of its importance to the states' reserves and ability to successfully administer their student loan programs because "severe economic implications" and "deleterious effects on agency cash flows" would result from even a mere delay in making reimbursement payments. *Id.*

"Rights against the United States arising out of a contract with it are protected by the Fifth Amendment." *Lynch*, 292 U.S. at 579. Petitioner has a constitutionally-protected "right to receive federal * * * funds by virtue of certain congressional enactments", *Oklahoma v. United States Civil Service Commission*, 330 U.S. 127, 135-36 (1947), because it complied with all statutory conditions that existed before the 1987 Amendments were enacted when it guaranteed over $1 billion in student loans. "[I]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously", *Pennhurst State School & Hospital v. Halderman*, 452 U.S. 1, 17 (1981), and no excess cash reserve transfer condition existed when Maryland guaranteed those loans.

Thus, notwithstanding the need to reduce the federal deficit, the Fourth Circuit was wrong when it held that the power to amend the student loan program overcomes the command of the Takings Clause. (App. at 11a.) The power to alter, amend or repeal legislation "cannot be used to take away property already acquired * * * or to deprive [a person] of the fruits already reduced to possession of contracts lawfully made. . . . " *Sinking Fund Cases*, 99 U.S. 700, 25 L.Ed. 496, 501 (1879). Congress is simply "without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an [unconstitutional] act of repudiation." *Lynch*, 292 U.S. at 580.

The massive "repudiation" at issue in this case involves the expropriation of $10.8 million of Maryland's reserves and the taking of $250 million from

guaranty agencies across the country. These agencies have guaranteed approximately $100 billion in 10 and 15-year student loans and are committed over an even longer period to spend enormous sums to service their huge loan portfolios. The reserves taken by the Secretary are crucial to the financial health and survival of state loan guarantee agencies, particularly if federal financial support declines, as it may well as part of the effort to reduce the federal deficit.[4]

The importance of these reserves is highlighted by the fact that at last count, in addition to the three states who were parties to the proceeding below, twenty-three other agencies have had their "excess cash reserves" appropriated by respondents *and* have challenged the constitutionality of the 1987 Amendments.[5] Further, two district courts in the proceed-

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[4] Maryland, for example, has incurred approximately $45 million in administrative costs with respect to its loan portfolio, which grew dramatically in the 1980's. These costs arose as a result of Maryland's enforcement of due diligence requirements, counseling financial institutions, monitoring the enrollment and repayment status of existing loans, providing pre- and post-default assistance to financial institutions, and collecting loans assigned by those institutions to Maryland after the loans have defaulted. The Secretary has only provided Maryland with approximately $10 million to partially offset these costs; the remaining costs have been offset by state appropriations and earnings derived from invested reserve funds. The Secretary's appropriation of $11 million of Maryland's reserves significantly hinders Maryland's long range efforts to administer its burgeoning loan portfolio.

[5] *See Student Loan Guarantee Foundation of Arkansas, Inc. v. Cavazos*, No. LR-C-88-862 (E.D. Ark. filed Dec. 15, 1988); *Colorado v. Cavazos*, No. 88-C-2073 (D. Colo. filed December 22, 1988) (consolidated with suits filed by Montana, New Mexico,

ings below (Maryland and South Carolina) and the District Court for the Southern District of Ohio have held that § 1072(e) is unconstitutional. *See Ohio Student Loan Commission v. Cavazos*, 709 F. Supp. 1411 (1989), *reversed*, 900 F.2d 898 (6th Cir. 1990). Review is warranted here, therefore, because the question presented by this petition is one over which the lower federal courts have differed and will likely differ in the future.

North Dakota, and Utah); *Connecticut Student Loan Foundation v. Cavazos*, No. H89-182 (D. Conn. Jan. 10, 1990) (Slip Op.); *Delaware v. Cavazos*, 723 F. Supp. 234 (D. Del. 1989); *Georgia Student Finance Commission v. Cavazos*, No. 1:89-CV-160-MHS (N.D. Ga. filed Jan. 26, 1989); *Indiana v. Cavazos*, No. IP 89-125-C (S.D. Ind. Jan. 29, 1990) (Slip Op.) (reversing the Secretary's actions and remanding for further proceedings); *Iowa v. Bennett*, No. 88-142-B (S.D. Iowa filed March 15, 1988); *Maine State Board of Education v. Cavazos*, No. 88-0273-B (D. Me. filed November 23, 1988); *Massachusetts Higher Education Assistance Corp. v. Cavazos*, No. 89-1325-K (D. Mass. filed June 5, 1989); *Michigan Higher Education Authority v. Cavazos*, No. L89-400/8CA (W.D. Mich. filed Feb. 13, 1989); *Missouri Coordinating Board of Higher Education v. Cavazos*, No. 88-4576-CV-C9 (W.D. Mo. filed Dec. 15, 1988); *New Hampshire Higher Education Assistance Foundation v. Cavazos*, No. C88-4-56-D (D.N.H. filed Nov. 16, 1988); *Ohio Student Loan Commission v. Cavazos*, 709 F. Supp. 1411 (S.D. Ohio 1988), *reversed*, 900 F.2d 898 (6th Cir. 1990); *Puerto Rico Higher Education Assistance Authority v. Cavazos*, No. 89-3069-TFH (D.D.C. filed Nov. 9, 1989); *Rhode Island Higher Education Assistance Authority v. Cavazos*, No. 89-0015T (D.R.I. filed Jan. 9, 1989); *Education Assistance Authority v. Cavazos*, ___ F.2d ___, No. 89-5393 (8th Cir. Apr. 10, 1990) (South Dakota); *Tennessee Student Assistance Corp. v. Cavazos*, No. 389-0261 (M.D. Tenn. filed Dec. 28, 1989); *Virginia State Education Assistance Authority v. United States*, No. 88-0874-R (E.D. Va. filed Dec. 30, 1988); *Great Lakes Higher Education Corp. v. Cavazos*, 711 F. Supp. 485 (W.D. Wis. 1989), *appeal pending*, No. 89-2748 (7th Cir.).

Additionally, the issue of whether the states have protected property interests in monies they are owed or hold to administer programs regulated by federal law will likely affect numerous other programs. This issue will arise every time Congress attempts to resolve the federal government's fiscal problems by retroactively redefining private money as "excess cash reserves". For example, if § 1072(e) is constitutional, Congress may well decide that it can reduce the huge and growing cost of the savings and loan bailout by appropriating the "excess reserves" of healthy federally-regulated financial institutions.

The Constitution places limits on the admittedly broad powers of Congress to regulate federal programs. Here, Congress has exceeded those powers by taking private property in the guise of regulation. This Court should grant this petition to reaffirm the principle that the federal government cannot take private property without paying just compensation.

CONCLUSION

For the reasons stated, this Court should issue a writ of certiorari to review the judgment of the Fourth Circuit. Following review, that judgment should be reversed.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff - Appellee

versus

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE HIGHER EDUCATION ASSISTANCE AUTHORITY

Amici Curiae.

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff - Appellee

versus

LAURO F. CAVAZOS, Secretary of Education; U.S. DEPARTMENT OF EDUCATION

Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeals from the United States District Court for the District of South Carolina, at Columbia. Karen L. Henderson, District Judge. (CA-88-2710-16-3)

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofit Maryland Corporation

Plaintiff - Appellee

versus

LAURO F. CAVAZOS, Secretary of the United States Department of Education

Defendant - Appellant

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the District of Maryland, at Baltimore. Frederic N. Smalkin, District Judge. (CA-89-270-S)

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiffs - Appellants

versus

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants- Appellees

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the Eastern District of North Carolina, at Raleigh. Terrence W. Boyle, District Judge. (CA 88-961-CIV-5)

Argued: October 3, 1989 Decided: March 7, 1990

Before RUSSELL, WIDENER, and HALL, Circuit Judges.

Affirmed in part, reversed in part, and remanded with instructions by published opinion. Judge Hall wrote the opinion, in which Judge Russell and Judge Widener joined.

Neil H. Koslowe, Special Litigation Counsel (Stuart E. Schiffer, Acting Assistant Attorney General; William Kanter, Deputy Director, Civil Division, DEPARTMENT OF JUSTICE; Edward C. Stringer, General Counsel; Harold Jenkins, Brian Seigel, Attorneys, DEPARTMENT OF EDUCATION, on brief) for Appellants. Andrew H. Baida, Assistant Attorney General (J. Joseph Curran, Jr., Attorney General; William F. Howard, Mary L. Preis, Assistant Attorneys General), on brief); James Emory Smith Jr. (Joseph D. Shine, Attorney General's Office; N. Bruce Holland, DEPARTMENT OF SOCIAL SERVICES, on brief); Thomas J. Ziko; Assistant Attorney General (Lacy H. Thornburg, Attorney General; Edwin M. Speas, Jr.,

Special Deputy Attorney General, on brief) for Appellees. (Jean Frohlicher, NCHELP, Inc.; George G. Olsen, Robert E. Jensen, WILLIAMS AND JENSEN, P.C., on brief) for Amicus Curiae NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC. (Mary Sue Terry, Attorney General; R. Claire Guthrie, Deputy Attorney General; Paul J. Forch, Senior Assistant Attorney General and Chief, Education Section; Richard C. Kast, Assistant Attorney General, on brief) for Amicus Curiae VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY.

HALL, Circuit Judge:

These consolidated appeals arise from actions filed by three different state-created agencies against the Secretary of the United States Department of Education ("Secretary") seeking to have certain portions of the 1987 amendments to the Higher Education Act of 1965 ("the Act") declared unconstitutional and to enjoin the Secretary from withholding payments to them in accordance with the amendments. In the South Carolina and Maryland cases, the district courts declared that the statutory provisions in question violated the Fifth Amendment's prohibition against the taking of private property without just compensation. The North Carolina court, however, upheld the statute's constitutionality. Finding that the amendments do not effect an unconstitutional taking, we reverse the South Carolina and Maryland judgments and remand for further proceedings. We affirm the judgment in the North Carolina case.

I.

A. Statutory Background

The Act established the Guaranteed Student Loan Program ("GSLP") to assist post-secondary school students. Under the GSLP, private lenders make low-interest loans,

subsidized by the federal government, to students. The lenders are insured by various state guaranty agencies that 100% of the unpaid principal of qualifying loans will be paid in case of default. Each state wishing to enable students to participate in the program must either establish its own guaranty agency or designate a private, non-profit agency to serve as such. This agency, in turn, must enter into written agreements with the Secretary by which it agrees to operate the program under GSLP guidelines. The Secretary is also authorized to enter into reinsurance agreements with the guaranty agencies by which the Secretary promises to reimburse between 80%-100% (depending on the agency's default rate) of the amounts expended by the guaranty agency in repaying the unpaid principal remaining on defaulted loans.

In addition to the reinsurance payments, the Secretary is authorized to make advances to enable a new agency to commence operation and administrative cost allowances to offset an agency's operating costs. Subject to statutory restrictions, a guaranty agency is also authorized to receive the following types of payments: (1) a single insurance premium on each loan (not to exceed 3% of the loan) which is paid by the lender and passed on to the student borrower; (2) a set portion of any amounts collected on defaulted loans for which the agency has received a reimbursement from the Secretary; (3) state appropriations; (4) gifts, grants and similar sources; and (5) investment earnings. Each guaranty agency is required to deposit these funds in a "reserve fund." 34 C.F.R. §682.410(a)(1). The reserve fund may only be used for those GSLP purposes specified by the Secretary, such as paying claims from lenders and administering the program, 34 C.F.R. §682.410(a)(2-6).

In response to concerns that these reserve funds had grown unnecessarily large, Congress enacted section 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (the "1987 Amend-

ments"). These amendments required the Secretary to determine, using a statutory formula, the maximum allowable cash reserve for each guaranty agency. 20 U.S.C. §1072(e)(2). The Secretary was also required to direct any state agency with an excess to transfer such amount to the Secretary. 20 U.S.C. §1072(e)(2)(A)-(D). Any amounts recovered from the excess reserves were to be deposited into a student loan insurance fund which is used by the Secretary to make reimbursement payments under the GSLP. 20 U.S.C. §1081(a). The Secretary is also authorized to waive repayment of any excess for certain specified reasons. 20 U.S.C. §1072(e)(3).

B. The Instant Dispute

1. The guaranty agency in South Carolina is the South Carolina State Education Assistance Authority ("Authority"). This non-profit agency was created by statute in 1976 to administer the GSLP. Under the excess reserve formula, the Secretary established a cash reserve ceiling of $500,000 and required the Authority to transfer the excess ($2,739,528). The Secretary denied the Authority's request for a waiver of this transfer requirement. When the Authority refused to transfer any of the excess amount, the Secretary began withholding reinsurance payments otherwise payable and applying these withheld amounts toward the $2.7 million due.

In October 1988, the Authority filed an action against the Secretary challenging the constitutionality of the excess reserve and related enforcement provisions of the 1987 amendments. The Authority also challenged both the Secretary's computation of the excess amount under the statutory formula and his denial of its request for a waiver. On May 31, 1989, the district court declared that the statutory provisions authorizing the withholding of reimbursements violated the Fifth Amendment's Takings Clause because the Authority had acquired "vested property rights" in such payments. Accordingly, the court enjoined

any further withholding of reimbursement payments and ordered the Secretary to release any amounts withheld. *S.C. State Educ. Assistance Authority v. Cavazos*, 716 F. Supp. 886 (D.S.C. 1989). The Secretary appeals from this order.

2. The guaranty agency in Maryland is the Maryland Higher Education Loan Corporation ("MHELC"), a non-profit corporation established by statute in 1963. MHELC entered into GSLP agreements with the Secretary in 1965. Under the statutory formula, the Secretary determined that MHELC was required to transfer $10,797,400 of its reserve fund. The Secretary denied MHELC's waiver request, and the guaranty agency subsequently refused to voluntarily transfer the excess amounts of its reserve fund. After the Secretary began to withhold reimbursement payments, MHELC filed suit for declaratory and injunctive relief. Unlike the Authority, however, MHELC did not challenge the Secretary's computation of its excess, nor did it challenge the denial of a waiver. The district court adopted the reasoning of the South Carolina court and granted the relief sought by MHELC. *Md. Higher Educ. Loan Corp. v. U.S. Dept. of Educ.*, Civ. No. S-89-270 (D. Md. June 12, 1989). The Secretary's appeal followed.

3. The North Carolina State Education Assistance Authority ("NCSEAA") was created by the state in 1965 to administer a higher education loan program. In 1966, NCSEAA entered into the first of several agreements with the Secretary by which North Carolina agreed to participate in the GSLP. In 1988, the Secretary informed NCSEAA that it had an excess reserve of $15,911,946. Upon partial approval of NCSEAA's request for a waiver, this amount was reduced to $2,632,785. NCSEAA refused to transfer any of its excess to the Secretary and, as in the Maryland and South Carolina situations, the Secretary began to withhold reimbursement payments otherwise payable under the GSLP.

NCSEAA filed an action in district court challenging, *inter alia*, the constitutionality of the 1987 amendments' excess reserve provisions. On July 20, 1989, the district court upheld the constitutionality of the excess reserve amendments on the ground that the funds in question are public, rather than private, property and, as such, were not within the ambit of the Fifth Amendment's Takings Clause. Accordingly, the Secretary's motion for summary judgment was granted. *State of N.C. v. United States*, 725 F. Supp. 874 (E.D.N.C. 1989). NCSEAA appeals from this ruling.

II.

In each contract with the Secretary, the executory state agency agreed "to be bound by all changes in the Act or regulations in accordance with their effective dates." The regulations include a similar requirement. 34 C.F.R. §682.400(d). The South Carolina court cites *The Sinking Fund Cases*, 99 U.S. (9 Otto) 700 (1879), and *Bowen v. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41 (1986), for the proposition that only an *express statutory* reservation in an act of the power to amend is effective to permit subsequent legislative alteration of agreements entered into by the federal government in conformity with such act. We do not read these cases so restrictively. In *Bowen*, although the power to amend was reserved in the authorizing legislation under which the agreements at issue were executed, the Court focused on the notice such express reservation provided to the state that the statute could be amended in the future. *Id.* at 53. Moreover, the Court in *Bowen* noted that the power to amend is deemed to have been reserved *unless* it is expressly relinquished. *Id.* at 52. As the Court noted, "contractual arrangements, including those to which a sovereign itself is party, 'remain subject to subsequent legislation' by the sovereign." *Id.* (quoting *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 147 (1982)). Accordingly, we find no merit in the agencies'

arguments that this power to amend was not reserved. *See also Great Lakes Higher Educ. Corp. v. Cavazos*, 711 F. Supp. 485, 494-96 (W.D. Wis. 1989); *State of Del. v. Cavazos*, 711 F. Supp. 234, 241-42 (D. Del. 1989). We turn, then, to the agencies' contentions that they had "vested property rights" which even a properly reserved power to amend could not reach.

III.

The constitutional provision at the core of these disputes is the Takings Clause of the Fifth Amendment: "[N]or shall private property be taken for public use, without just compensation." Simply stated, the state agencies contend that the transfer requirement of 20 U.S.C. §1072(e)(2) contravenes this constitutional provision because the agencies' reserve funds constitute "private property" accrued pursuant to contracts with the Secretary. We agree with the Secretary and the North Carolina district court, however, that the excess reserve funds are not "private property" within the meaning of the Takings Clause.

The essential aspects of private property are "free use, enjoyment and disposal," *Buchanan v. Warley*, 245 U.S. 60, 74 (1917), and the "right to exclude others," *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984). As explained in *Ruckelshaus*, such property interests " 'are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law' [citations omitted]." *Id.* at 1001. The nature of the loan program militates against a finding that the state agencies possessed such indicia of private ownership. As the North Carolina district court stated, "[i]f property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, then it loses its character as 'private' property and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment." *State of N.C. v. United States*, 725 F. Supp. at

876-77 (E.D.N.C. 1989). We agree that the regulations which completely control the reserve funds' uses are the sort of "existing rules or understandings" which prevent any of the guaranty agencies from acquiring an ownership interest in its reserve fund which would entitle it to protection as private property under the Takings Clause.

IV.

An alternative argument raised by the state agencies focuses not on the reserve fund itself as the property allegedly being taken but, rather, on the enforcement mechanism of the 1987 amendments which the state agencies claim acts to take their "vested contractual rights" to receive reimbursement payments. The South Carolina district court held that even if the power to amend had been effectively reserved, the contractual right to reimbursement payments had already vested in the Authority with regard to default payments already made. 716 F. Supp. at 794. The court's analysis proceeds from the principle that contractual rights are generally recognized to be property for purposes of the Takings Clause. *See, e.g., Lynch v. United States*, 292 U.S. 571, 579-80 (1934). Citing *The Sinking Fund Cases*, 99 U.S. at 719-21, the South Carolina court recognized that there exist some limits on the federal government's power to unilaterally amend its contracts and concluded that the 1987 Amendments had exceeded such limits. For a number of reasons, however, we believe that the state agencies' "contractual rights" to reimbursement payments had not "vested" so as to trigger Fifth Amendment protections.

The analysis of the vested/non-vested nature of the right to reimbursements is intertwined with the earlier discussion of the nature of the reserve funds themselves. The reserve funds are generated solely within the framework of a federal social welfare program involving students and prospective students throughout the nation. Just as the complete federal control over the use of the fund compels

the conclusion that the targeted funds do not constitute private property for Fifth Amendment purposes, the contractual right to reimbursement payments destined for inclusion in such reserve funds similarly is not the type of property subject to the "takings" prohibition. The reservation of the power to amend the terms of the GSL program prevents the participating state agencies from invoking the Fifth Amendment Takings bar against subsequent Congressional action. *Great Lakes Higher Educ. Corp.*, 711 F. Supp. at 495-96. The Court in *Bowen* emphasized that the sovereign authority to alter its contracts by subsequent legislation should not, if possible, be foreclosed and especially so in the context of a "comprehensive social welfare program." 477 U.S. at 52-53. We conclude that the public nature of the reserve funds themselves, coupled with the express contractual reservation of the power to amend the terms of the GSL program and the fact that the legislative changes involve a comprehensive federal/state social welfare program, forecloses a finding that the state agencies have obtained unalterable vested property rights to certain payments.

V.

For the foregoing reasons, the judgments in the South Carolina and Maryland cases are reversed and these cases are remanded for further proceedings consistent with this opinion. The judgment in the North Carolina case is affirmed.

Nos. 89-2975/76/78 - *REVERSED AND REMANDED*

Nos. 89-2982 - *AFFIRMED*

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiff - Appellee

v.

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States Department of Education; U.S. DEPARTMENT OF EDUCATION;
Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY
Amici Curiae

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofit Maryland Corporation
Plaintiff - Appellee

v.

LAURO F. CAVAZOS, Secretary of the United States Department of Education
Defendant - Appellant

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiff - Appellee

v.

LAURO F. CAVAZOS, Secretary of Education; U.S. DEPARTMENT OF EDUCATION
Defendants - Appellants

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiffs - Appellants

v.

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION
Defendants - Appellees

On Petitions for Rehearing with Suggestions for Rehearing In Banc

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The appellees South Carolina State Education Assistance Authority and Maryland Higher Education Loan Corporation and appellants State of North Carolina and North Carolina Education Assistant Authority's petitions for rehearing and suggestions for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestions for rehearing in banc, and

As the panel considered the petitions for rehearing and is of the opinion that they should be denied,

IT IS ORDERED that the petitions for rehearing and suggestions for rehearing in banc are denied.

Entered at the direction of Judge Hall with the concurrence of Judge Russell and Judge Widener.

For the Court,

JOHN M. GREACEN
CLERK

FILED: MARCH 28, 1990

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

CIVIL NO. S-89-270

MARYLAND HIGHER EDUCATION LOAN CORPORATION

v.

UNITED STATES DEPARTMENT OF EDUCATION, *et al.*

ORDER AND DECLARATION

Upon consideration of plaintiff's and defendants' cross-motions for summary judgment and the oppositions thereto, IT IS, this 12th day of June, 1989, for reasons stated in a Memorandum Opinion, ORDERED, DECREED AND ADJUDGED:

1. That plaintiff's motion BE, and it hereby IS, GRANTED; and that defendants' motion BE, and it hereby IS, DENIED;

2. That plaintiff, Maryland Higher Education Loan Corporation (MHELC), has a statutory right to be reimbursed by defendants for money paid by MHELC to lenders of defaulted loans guaranteed by MHELC and reinsured by defendants prior to December 22, 1987;

3. That 20 U.S.C. § 1072(e) violates the Fifth Amendment to the United States Constitution and it is therefore null, void, and unenforceable;

4. That MHELC's reinsurance contracts with defendants remain in full force and effect according to their terms, unaffected by 20 U.S.C. § 1072(e), that MHELC is entitled to full reimbursement pursuant to the contracts as they existed on December 22, 1987, and that the defendant Department is not entitled to capture "excess cash reserves" under § 1072(e);

5. That defendants are permanently enjoined from enforcing § 1072(e) against MHELC; and

6. That the Clerk of Court mail copies of the foregoing Memorandum Opinion and of this Order and Declaration to counsel for the parties.

/s/
Frederic N. Smalkin
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

CIVIL NO. S-89-270

MARYLAND HIGHER EDUCATION
LOAN CORPORATION

v.

UNITED STATES DEPARTMENT
OF EDUCATION, et al.

MEMORANDUM

This is a case brought by the Maryland Higher Education Loan Corporation, a non-stock, non-profit corporation organized under the Education Article of the Maryland Annotated Code, seeking declaratory and injunctive relief against the United States Department of Education, which it accuses of unconstitutionally interfering with its property and contractual rights under the Higher Education Act of 1965, as amended, 20 U.S.C. § 1071 *et seq.* In particular, the plaintiff is aggrieved by the enactment of a certain amendment to the Higher Education Act of 1965, contained in the Omnibus Budget Reconciliation Act of 1987, Pub. L. 100-203. The particular amendment in question, effective December 22, 1987, added subsection (e) to 20 U.S.C. §1072, authorizing the Secretary of Education to determine whether state loan administration bodies such as the plaintiff have excess cash reserves and, if so, to recapture such reserves by certain means, including refusal to make reinsurance payments on guaranteed loans which were in place prior to December 22, 1987. Pursuant to longstanding contracts with the United States Government, the plaintiff, a state agency guaranteeing loans made to students by lenders of first resort, is entitled to be

reimbursed by the federal government for losses in connection with student loans. (These losses, with respect to pre-December, 1987 loans, might not become evident for some time.) Thus, there is an active dispute between the parties as to the status of many millions of dollars which the defendants claim as excess cash reserves, and which the plaintiff does not want to give back. Plaintiff asserts that Congress had no right to force it to give the money up, or to penalize it for not doing so by authorizing the withholding of reinsurance payments in respect of pre-December, 1987 loans.* The parties have filed cross-motions for summary judgment, which have been fully briefed. No oral hearing is deemed necessary. Local Rule 6, D. Md.

This case raises constitutional issues that have been fully treated in the opinions of three United States District Courts. In *Ohio Student Loan Commission v. Cavazos*, Judge Graham, of the Southern District of Ohio, found the amendment in question unconstitutional, on a number of grounds fully described in his opinion. *Ohio Student Loan Commission v. Cavazos*, No. C-2-88-314 (S.D. Ohio 1988) to be reported at 709 F. Supp. 1411. On the other hand, Chief Judge Crabb, of the United States District Court for the Western District of Wisconsin, held that the statutory amendment in question is constitutional. *Great Lakes Higher Education Corp. v. Cavazos*, No. 88-C-159-C, 1989 WL 38578 (W.D. Wis. Apr. 14, 1989). The latest decision is that of Judge Henderson of the District of South Carolina. In *South Carolina State Education Assistance Authority v. Cavazos*, Civil No. 3-88-2710-16 (D.S.C. 1989), decided May 31, 1989, Judge Henderson held that the amendment in question is unconstitutional, because it works a taking of property without just compensation, in violation of the Fifth Amendment of the United States Constitution.

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* The statute provides for a waiver from the recapture/withholding process, but the plaintiff's request for a waiver was denied by the defendants.

Having weighed and considered the issues in light of the authorities cited above, and the authorities cited within those authorities, this Court has reached the conclusion that the amendment in question is unconstitutional, as a prohibited taking of the plaintiff's property by the United States Government, without just compensation. Because this Court could not improve upon the excellent analysis embodied in Judge Henderson's opinion in the *South Carolina* case, the Court hereby incorporates and adopts that opinion as its reasons for decision in this case. (A copy of Judge Henderson's opinion is attached hereto). In a nutshell, the excess cash reserves are the property of the plaintiff, and, despite language making the plaintiff's contract with the defendants conformable to legislative changes, the federal government cannot simply take the cash reserves away from the plaintiff, especially through the vehicle of reneging on its obligation to reimburse for losses experienced by plaintiff in connection with previously guaranteed loans.

For the reasons stated, an order will be entered separately, granting the plaintiff's motion for summary judgment, and decreeing the appropriate relief.

/s/
Frederic N. Smalkin
United States District Judge

Dated: June 12, 1989

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA
COLUMBIA DIVISION

CIVIL ACTION NO. 3:38-2710-16

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY,

Plaintiff,

v.

LAURO F. CAVAZOS, in his official capacity as Secretary, United States Department of Education, and UNITED STATES DEPARTMENT OF EDUCATION,

Defendants.

ORDER

I.

This matter is before the Court on cross motions for summary judgment pursuant to Fed. R. Civ. P. 56. All parties agree that no issue of material fact exists and that this matter should be resolved as a matter of law. For the reasons set forth below, the Court grants the plaintiff's motion for summary judgment and denies the defendants' motion.

The South Carolina State Education Assistance Authority ("Authority") is a non-profit agency that guarantees student loans under the federal Guaranteed Student Loan Program ("GSLP"). The GSLP is the largest federal program providing financial assistance to students seeking a post-secondary education. Under the GSLP, various lenders such as commercial banks and savings and loan institutions make low-interest loans to students. The loans are subsidized by the federal government and are further pro-

tected by guarantees made by fifty-eight state or private, non-profit agencies. These guarantors are reinsured by the United States Department of Education ("DOE"). The Authority is one such guarantor.

The Authority is the middleman of the GSLP, serving as the link between the lender and the DOE. It collects premiums from lenders (who pass on the premium cost to loan recipients) in exchange for its agreement to repay loans in default due to death, disability, bankruptcy or default of the borrower. When a default occurs the lender files a claim with the Authority and the Authority pays the claim. The Authority attempts to collect from the borrower the loan on which it has paid the default claim. The Authority also encourages program participation and verifies that lenders exercise due diligence. In addition to the premiums collected from lenders, the Authority is also funded by federal advances, federal administrative cost allowances and federal reinsurance payments; collections on defaulted loans; state appropriations; investments; and other sources.

The DOE administers the GSLP nationwide. It has numerous functions including the oversight of the operations of the lenders and guaranty agencies. The DOE makes subsidized interest and special allowance payments directly to the lenders and it reinsures the guarantees issued by the guaranty agencies. If a guaranty agency pays a lender's default claim, and both have exercised due diligence, the DOE makes a reinsurance payment to the guaranty agency. The DOE also reimburses the guaranty agency for a portion of its administrative costs and provides advances to help it maintain adequate cash reserves for claims and other expenses. The relationship between the DOE and a guaranty agency is set forth in written agreements which are governed by certain federal statutes.

Under the Higher Education Act of 1965, 20 U.S.C. §§1071 *et seq.* ("the Act"), as amended in 1986, guaranty

agencies are required to insure one hundred percent of the loan amounts for which they issue guarantees. 20 U.S.C. §1078(b)(1)(G). The DOE, in turn, must reimburse one hundred percent of the amount expended by the agencies under its reinsurance obligations unless their claims rate exceeds a certain level. The 1986 amendments to the Act expressly grant "a contractual right" to guaranty agencies "as against the United States" to receive reinsurance payments and administrative cost allowances from the DOE. Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1268, 1376.

Congress became concerned about the federal costs associated with the program in 1986 and considered numerous amendments to reduce costs. Even as Congress worried about the federal costs, some state and private guarantors apparently were accumulating large surpluses in their reserve funds.[1] As a result of Congress's concern, the United States Comptroller General made numerous recommendations for reducing the federal costs attending the GSLP.

This action arises out of one of the Comptroller's recommendations accepted by Congress and included in the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 ("1987 amendments"), which was enacted on December 22, 1987 and will expire on September 30, 1989. The critical amendment establishes a cap on the amount of "excess reserves" that a guaranty agency may keep on hand and attempts to recoup all reserves beyond that cap. The 1987 amendments establish a formula, now codified at 20 U.S.C. §1072(e)(1), for determining the maximum amount of funds a guaranty agency may accumulate in its reserve fund.

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[1] The term "reserves" is not defined in the Act or the DOE regulations. It refers to the reservoir of funds held by a guaranty agency for future contingencies, and it represents the cumulative amount of money available when the agency's total expenditures are subtracted from its total revenue.

Under 20 U.S.C. §1072(e)(2) the DOE Secretary must direct an agency whose cash reserves exceed the ceiling to "eliminate" the excess by (1) repaying advance payments that are not otherwise due; (2) withholding and cancelling reimbursement claims that are otherwise payable; (3) reducing the amount to be claimed for administrative costs; (4) paying an additional reinsurance fee; or (5) adopting any other acceptable method of reducing payments from or increasing payments to the federal government. The recovered amounts are deposited in the student loan insurance fund established by 20 U.S.C. §1081(a) and are used exclusively for GSLP purposes.

The 1987 amendments authorize the Secretary to waive the requirements of 20 U.S.C. § 1072(e)(2) under an administrative appeals procedure. A waiver may be granted if an agency would be compelled to violate contractual obligations existing on December 22, 1987, that require a specific level of cash reserves. A guaranty agency must apply for a waiver and the Secretary must respond in an expedited manner.

The 1987 amendments also modify the provisions granting the guaranty agency a "contract right" to reinsurance payments, administrative cost allowances and advances by making them subject to the cash reserve ceiling provisions. The amendments provide that a guaranty agency "shall, *subject to section 1072(e) of this title* [*the cash reserve ceiling provisions*], be deemed to have a contractual right against the United States" to receive reimbursement for losses on insured loans. Similarly, the amendments provide that a guaranty agency "shall, *subject to section 1072(e) of this title*, be deemed to have a contractual right against the United States" to receive administrative cost allowances. Thus, although the Act had earlier expressly granted to the guaranty agency contractual rights to reinsurance reimbursements and administrative cost allowances, the 1987 amendments now make these rights contingent on the size of the agency's reserves.

On February 9, 1988, the Secretary notified the Authority that it had $2,739,528 in excess cash reserves and that it was required to eliminate the excess by one of the statutorily prescribed methods. Since that date the Authority has continued to submit requests for reinsurance and administrative cost reimbursements to the Secretary and the Secretary has refused to honor those requests. The reinsurance payments now being withheld relate to loans guaranteed by the Authority prior to enactment of the 1987 amendments. The Authority applied for a waiver on the ground that it would be compelled to violate contractual obligations existing on December 22, 1987, if the 1987 amendments were applied to it but the Secretary denied the application. The Authority sued the DOE on October 17, 1988.[2] The parties have stipulated that the amount in controversy is $2,657.87.[3]

The Authority advances seven causes of action. In the first two causes of action it contends that the 1987 amend-

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[2] At least three other district courts have issued rulings in virtually identical actions. In *Great Lakes Higher Education Corp. v. Cavazos*, No. 88-C-159-C (W.D. Wis. April 17, 1989), the District Court for the Western District of Wisconsin denied the plaintiff's motion for a preliminary injunction to enjoin the DOE from withholding reimbursement payments from the plaintiff because the plaintiff had an adequate remedy at law. The court in *Great Lakes* later granted summary judgment in favor of the DOE, discussed in greater detail, *infra*. The District Court for the Eastern District of Virginia likewise refused to grant the plaintiff temporary injunctive relief in *Virginia State Education Assistance Authority v. Cavazos*, No. 88-0874-R (E.D. Va. Jan. 10, 1989). In *Ohio Student Loan Comm'n v. Cavazos*, No. C-2-88-0314 (S.D. Ohio Dec. 19, 1988), the court held that the amendments are unconstitutional on several different grounds. On March 10, 1989, it issued an additional order rejecting new arguments of the plaintiff. The Sixth Circuit recently stayed the district court's order. *Ohio Student Loan Comm'n v. Cavazos*, No. 89-3168 and No. 89-3238 (6th Cir. filed May 23, 1989).

[3] Although the defendants have claimed $2,739,528 from the Authority, the Authority has agreed to pay $81,841 of this sum which, when deducted, leaves $2,657,687 as the amount in controversy.

ments constitute a "taking" without compensation of its property rights in its contracts with the defendants and in its cash reserve fund in violation of the fifth amendment to the United States Constitution.[4] In the third cause of action, the Authority contends the 1987 amendments arbitrarily distinguish between guaranty agencies with excess cash reserves and those without cash reserves in violation of the equal protection clause of the fourteenth amendment to the United States Constitution. In the fourth cause of action, the Authority contends that the amendments breach its contracts with the defendants. In the fifth cause of action, the Authority contends the Secretary erroneously calculated the amount of its excess cash reserves in violation of the 1987 amendments. In the sixth cause of action, the Authority contends that elimination of its excess cash reserves would cause it to violate contractual obligations contrary to one of the provisions in the 1987 amendments. In the seventh cause of action, the Authority contends that the 1987 amendments call into question the validity of public debt in violation of section four of the fourteenth amendment to the United States Constitution.[5]

The Authority seeks both declaratory and injunctive relief. It seeks a declaration that the 1987 amendments are unconstitutional, that the defendants miscalculated the amount of its excess cash reserves and that the defendants erroneously failed to grant it a waiver of the requirements imposed by the 1987 amendments. The Authority also seeks to enjoin the defendants from offsetting amounts owed by the federal government against its debt under the 1987 amendments.

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[4] U.S. Const. amend. V provides in part that "private property [shall not] be taken for public use, without just compensation."

[5] U.S. Const. amend. XIV, §4 provides in part: "The validity of the public debt of the United States, authorized by law, . . . shall not be questioned."

The Authority originally moved for a preliminary injunction but that motion was withdrawn; both the Authority and the defendants have now moved for summary judgment on all issues.

II.

As noted earlier, Congress in 1986 expressly granted to the Authority a contractual right to receive the reinsurance reimbursement and the administrative cost allowances. Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1268, 1376. Congress then made the contractual rights subject to the 1987 amendments regarding limits on excess reserves. The Authority argues that Congress cannot relieve itself retroactively of its contractual obligations; on the other hand, the defendants argue that Congress is authorized to alter its obligations under this program.

The arguments on both sides revolve primarily around *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 106 S.Ct. 2390 (1986), and the *The Sinking Fund Cases*, 99 U.S. (9 Otto) 700 (1879). In *The Sinking Fund Cases* Congress attempted to amend contracts the federal government had entered into with certain railroad companies. According to the contracts, Congress provided land to the railroads and entered into an agreement requiring the railroads to provide full payment for the land in thirty years. The railroads agreed to furnish the government with transportation and telegraph transmissions on a preferential basis and to set aside toward payment of the principal and interest due on the subsidy bonds issued by Congress to finance railroad expansion fifty percent of the compensation due for these services plus five percent of annual net earnings. Apparently, the railroad companies accumulated more debt in extending the railroads than Congress had anticipated; despite the accumulation of debt, however, the railroads declared dividends rather than setting aside money for repayment of the subsidy bonds.

Fearing that the railroads would not have enough to pay the substantial debt when it came due, Congress amended the legislation to require that the government apply one hundred percent of the compensation due the railroads to the other sources (one-half to interest debt on the subsidy bonds and the other half invested in United States bonds in a sinking fund established in the United States Treasury). The railroads were also required to pay twenty-five percent of their earnings into the sinking fund. Proceeds of the sinking fund were to be used to pay all remaining interest and principal due on the subsidy bonds on the date of their maturity.

The United States Supreme Court held that the amendments did not deprive the railroads of due process.[6] The Court first noted that Congress, in the original legislation, had expressly reserved the right to amend the legislation. 99 U.S. at 719-20. The Court declared, "It is unnecessary to decide what power Congress would have over the charter if the right of amendment had not been reserved; for as we think, that reservation has been made." *Id.*

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[6] Before beginning its analysis, the Court noted that the United States is "prohibited from depriving persons or corporations of property without due process of law." 99 U.S. at 501. Whether the *The Sinking Fund* cases are pure "due process" cases or whether the Court's analysis applies equally well to fifth amendment "taking without just compensation" and fourteenth amendment "questioning of the public debt" cases is unclear. Mr. Chief Justice Waite described the issue as whether the amended statute "deprives the Company of its property without due process of law, *or in any other way improperly interferes with vested rights.*" *Id.* (emphasis added). Moreover, other decisions addressing similar facts have loosely referred to the *The Sinking Fund Cases* both as taking cases, *see Bowen v. Public Agencies Opposed to Social Security Entrapment* 477 U.S. 41, 48 (1986), and as questioning of the debt cases, *see Perry v. United States*, 294 U.S. 330, 354 (1934). Based on *Bowen* as well as on the breadth of the *The Sinking Fund Cases* holding itself this Court views *The Sinking Fund Cases* language establishing limits on legislation that alters the United States' contractual obligations as based not only on the due process clause of the fifth amendment but also on the taking clause of that amendment.

Next, the Court noted numerous factors underlying its decision: (1) the railroads had been paying money in dividends rather than preparing to pay a certain, and large, debt to the government; (2) the government was both a sovereign and a creditor, and "[t]heir rights as sovereign are not crippled because they are creditors, and their privileges as creditors are not enlarged by the charter because of their sovereignty," *id.* at 724; and (3) "The original contracts of loan are not changed. They remain as they were before, and are only to be met at maturity. All that has been done is to make it the duty of the Company to lay by a portion of its current net income to meet its debts when they do fall due." *Id.* at 725.

The Court in *The Sinking Fund Cases*, however, used strong language in setting the outer limits of Congress's authority to alter its contractual obligations:

> [Congress] cannot legislate back to [itself], without making compensation, the lands they have given this Corporation to aid in the construction of its railroad. Neither can they by legislation compel the Corporation to discharge its obligations in respect to the subsidy bonds otherwise than according to the terms of the contract already made in that connection. The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen. No change can be made in the title created by the grant of the lands, or in the contract for the subsidy bonds, without the consent of the corporation. All this is indisputable.

99 U.S. at 719.

In addition, the Court decided that, even if Congress expressly retains authority to amend its contracts in the

legislation authorizing the contracts, it cannot take away benefits already conferred under the contracts:

> That this power [to alter obligations under a contract by amending authorizing legislation] has a limit, no one can doubt. All agree that it cannot be used to take away property already acquired under the operation of the charter, or to deprive the Corporation of the fruits actually reduced to possession of contracts lawfully made. . . .
>
> . . . [W]hatever rules Congress might have prescribed in the original charter for the government of the Corporation in the administration of its affairs, it retained the power to establish by amendment. In so doing it cannot undo what has already been done, and it cannot unmake contracts that have already been made, but it may provide for what shall be done in the future, and may direct what preparation shall be made for the due performance of contracts already entered into.

Id. at 720-21.

The United States Supreme Court addressed a similar issue in *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986). The issue there was whether, by amending the social security legislation, Congress could deprive a state of the prerogative originally granted in that statute and in an agreement tracking the statutory language to withdraw from the social security program. The Court held that Congress had in the original act reserved the power to amend it and could so amend it because the act itself created no property right under the fifth amendment. The Court observed that "[t]he State accepted the Agreement under an Act that contained the language of reservation. That language expressly notified the State that Congress retained the power to amend the law under which the Agreement was executed and by

amending that law to alter the Agreement itself." *Id.* It continued, "Congress does not have the power to repudiate its own debts, which constitute 'property' to the lender, simply in order to save money," but the section of the social security act at issue was neither a debt of the United States nor an obligation of the United States to provide benefits under a contract for which the obligee paid a monetary premium, and hence did not rise to the level of a protected property right. *Id.* at 55.

Thus, under *The Sinking Fund Cases* and *Bowen*, Congress can alter its agreements if it expressly retains that right in the legislation under which agreements are entered into. As a limit on that rule, however, the United States Supreme Court has made clear that Congress cannot "unmake" contracts in which the other party has acquired a property right, even if it has retained the authority to amend the legislation and thereby the contracts. The first question here, then, is whether the Authority has acquired a property right in the contracts it entered into with the Secretary pursuant to the Higher Education Act before the 1987 amendments. If the Authority has a property right under the contracts to receive reimbursement for guaranty payments and administrative cost allowance, Congress cannot empower the defendants to take away that property right without either the Authority's consent or just compensation.

In *White v. United States*, 270 U.S. 175 (1926), and *Lynch v. United States*, 292 U.S. 571 (1934), the United States Supreme Court established guidelines for determining when a party to a contract with the federal government has an enforceable property right in the contract. In *White* a soldier purchased a life insurance policy from the government and named his mother and his aunt as beneficiaries of one-half of the proceeds each. When he entered into the contract, the statute providing the insurance did not list "aunts" as allowed beneficiaries. Before he died the statute was amended to include aunts as be-

neficiaries. Later, after the insured died, his mother contended that she was entitled to the full proceeds because the amendment could not constitutionally alter the terms of the statute in effect when her son purchased the insurance. The certificate of insurance provided that it was " 'subject in all respects to the provisions of such Act, of any amendments thereto, and of all regulations thereunder, now in force or hereafter adopted, all of which, together with the application for this insurance, and the terms and conditions published under authority of the Act, shall constitute the contract.' " *White*, 270 U.S. at 180. The Court ruled against the mother, basing its decision on the facts that the policy was a contract between the deceased and the government, it was expressly subject to changes in the governing statute and the insured's mother could have acquired no rights under the contract until the son died, which occurred after the amendment to the statute. Because the plaintiff (the mother) was not a party to the contract and her interest could not have vested until after the amendment was enacted, the issue presented and decided was a standing issue, that is, "one whose vested rights were not thereby disturbed could not complain of subsequent legislation affecting the terms of the policy." *Lynch*, 292 U.S. at 577. The questions left unanswered by *White* include when a party's rights are considered vested and, if vested, when they can be divested by subsequent legislation.

Lynch assisted in answering these questions. There, beneficiaries under government-issued life insurance policies claimed that Congress unconstitutionally repealed the act providing for the policies after having issued and accepted premiums for the policies. The Court declared, apparently on both due process and taking without compensation grounds, that the amendment disavowing the insurance policies was unconstitutional:

> The repeal, if valid, abrogated outstanding contracts; and relieved the United States from all

> liability on the contracts without making compensation to the beneficiaries.
>
> . . . The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a principality, a State or the United States. Rights against the United States arising out of a contract with it are protected by the Fifth Amendment.
>
> . . .
>
> In the administration of all government business economy had become urgent because of lessened revenues and the heavy obligations to be issued in the hope of relieving widespread distress. Congress was free to reduce gratuities deemed excessive. But Congress was without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would not be the practice of economy, but an act of repudiation.

Id. at 579-80.[7]

Significantly, the original act in *Lynch* did not include language reserving to the government the right to alter the contracts entered into under the statute by amendment, unlike the legislation in *The Sinking Fund Cases* and in *Bowen*. The contracts of insurance themselves, however, stated that the policy "should be subject to all amendments to the original Act, to all regulations then in force or thereafter adopted." *Id.* The policy form in which this language appeared was prepared by the Veterans Administration. The Court nevertheless concluded that "no power to curtail the amount of the benefits which Congress

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[7] *See id.* at 579 (for due process discussion); *see infra* n.9.

contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator." *Id.* at 578. In this Court's view, *Lynch* manifests that language reserving to Congress the power to amend legislation and contracts entered under it must be in the legislation itself to be effective.

The defendants argue, however, that no property right vested in the Authority because the Secretary included, in the regulations issued pursuant to the Higher Education Act and in the contracts between the Authority and the DOE, language reserving to Congress the right to amend the contracts. The defendants rely on the Supreme Court's language in *Bowen* that the provision of the legislation at issue there "simply cannot be viewed as conferring any sort of 'vested right' in the face of precedent concerning the effect of Congress' reserved power on agreements entered into under a statute containing the language of reservation." *Bowen*, 477 U.S. at 55. The Court concluded, therefore, that "[s]ince appellees had no property right in the termination clause, [the statute] did not effect a taking within the meaning of the Fifth Amendment." *Id.* at 55-56.

On the basis of this language the defendants argue that the Authority could not possess a property right in its contracts with the federal government because of the notice of Congress's ability to amend the Higher Education Act contained in the Secretary's regulations and in the contracts. Indeed, a recent opinion supports the defendants' reading of *Bowen*. In *Great Lakes Higher Education Corp. v. Cavazos*, No. 83-C-159-C (W.D. Wis. April 17, 1989), the court interpreted *Bowen* to mean that "a contractual right arising out of a contract governed by an act subject to the express reservation of Congress's power to amend is not a right that constitutes property protected by the Fifth Amendment." *Id.* at 21.

This Court does not agree with the defendants' argument or with the ruling in *Great Lakes*. First, such a reading of *Bowen* disregards the development of the law in this area beginning with *The Sinking Fund Cases*. In *The Sinking Fund Cases* the Supreme Court expressly declared that, regardless of whether Congress reserves the power to amend an agreement made pursuant to a statute by amending the statute, Congress's power to amend an agreement has limits, as this Court earlier discussed, *supra*. If, as the defendants contend, a party to a contract with the federal government under these circumstances does not possess a property right in its contract with the government, then, contrary to *The Sinking Fund Cases*, the power of Congress to alter its obligations under a contract containing a reservation of power to amend would be effectively unlimited because no party to that contract could ever acquire a property right to the benefits due under the contract. Faith in contracts with the government would be seriously shaken by such a ruling.

The defendants' and *Great Lakes*'s reliance on *Bowen*, however, is misplaced. First, unlike the reservation of Congress's power in the *Bowen* legislation, the reservation of power to amend the contracts made under the Higher Education Act is contained not in the Act, but instead only in the regulations issued by the Secretary and in the contracts themselves.[8] *Lynch* makes clear the significance of this distinction in holding that a reservation of power to amend the act in question contained only in the regulations promulgated under the act and in the insurance contract authorized by the act but not in the act did not reserve to Congress amendatory power. As noted earlier,

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[8] The agreements expressly provide that the Authority "shall be bound by all changes in the Act or Regulations in accordance with their effective dates." Complaint, Exhibit B, ¶1. The Secretary's regulations similarly provide that all agreements are "subject to subsequent changes in the Act or the regulations that apply to the [GSL] Program." 34 C.F.R. 682.400(d).

the Supreme Court held that "no power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator." *Lynch*, 292 U.S. at 578. Applying this language here, this Court concludes that the Secretary cannot in his regulations reserve to Congress the power to amend its contracts with the Authority by amending the statute under which the contracts were entered into; only Congress can do that. Nor can such power be created by a term in the contract between the Secretary and the Authority. Nonetheless the defendants argue that, because notice of reservation is included in the contract and because the Authority is more likely to read the contract than the statute, the notice here is sufficient. The issue, however, is not notice; the issue is whether Congress reserved the *power* to amend the contract. Here, it did not, and the notice provisions in the contract and in the regulations cannot grant such power.

Accordingly, the Court concludes that here, as in *Lynch*, the Authority has vested property rights in its contracts with the United States to receive reimbursement for payments made to guarantee defaulted loans and to receive advances and administrative cost allowances. As in *Lynch*, the Authority is a party to the contract and has paid valuable consideration for its right to receive reinsurance payments, administrative cost reimbursements and advances—it has agreed to guarantee the loans and it has administered the GSLP on the state level, acting as the middleman between the federal government and the lending institutions. Furthermore, Congress expressly provided in the 1986 amendments that the Authority has a "contractual right" to receive reinsurance payments and administrative cost allowances. This Court rejects the reasoning in *Great Lakes* that these rights could not vest, and instead finds that the Authority's rights constitute property. Because they do constitute property, then, even

if a reservation of power to amend the contracts were contained in the legislation authorizing them, Congress could not by amending the legislation take away that property. *The Sinking Fund Cases*, 99 U.S. at 720.

This Court further rejects the defendants' argument that they may withhold these payments as a means of enforcing the requirement in the 1987 amendments that the Authority reduce its excess cash reserves. The defendants contend that the federal government regularly withholds funding for certain programs in order to assure compliance with certain policies and that the withholding of reinsurance payments here is no different. Here, however, the requirement that the Secretary is attempting to enforce is itself not binding on the Authority. "The United States are as much bound by their contracts as are individuals." *Id.* at 719. Thus, just as the Authority could not unilaterally require the Secretary to pay it additional consideration to continue its role in the GSLP, the Secretary cannot unilaterally require the Authority to pay ransom in order to continue receiving both reimbursements for monies already paid out and administrative cost allowances and advances in accordance with the contract.

Finally, there is no difference of legal significance among the prescribed methods the defendants are authorized to use to enforce the 1987 amendments. Regardless of the means chosen to attempt to force the Authority to comply with the requirements of the 1987 amendments, any attempt to coerce its compliance without just compensation constitutes an unconstitutional taking of the Authority's property rights in its contracts with the federal government under the fifth amendment to the United States Constitution and is therefore unconstitutional.

III.

Accordingly, the Court declares that the 1987 amendments authorize the taking of the Authority's property

without just compensation in violation of the fifth amendment to the United States Constitution and are unconstitutional.[9] The Secretary is enjoined from offsetting the Authority's excess cash reserves against future reinsurance payments or other federal payments to which the Authority would otherwise be entitled pursuant to its contracts with the United States. The defendants are ordered to release to the Authority the funds which they have wrongfully withheld within thirty days of the date this order is filed.

IT IS SO ORDERED.

/s/
KAREN LeCRAFT HENDERSON
UNITED STATES DISTRICT JUDGE

Columbia, South Carolina
May 31, 1989

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[9] Because the Court finds the 1987 amendments violate the fifth amendment proscription against taking property without just compensation, it does not reach the Authority's claims that the amendments violate the due process clause of the fifth amendment, the equal protection clause of the fourteenth amendment and the questioning of the public debt clause of the fourteenth amendment. The Court also does not reach the Authority's allegations that the Secretary miscalculated its excess reserves and that he erroneously failed to grant a waiver to the Authority.

UNITED STATES CONSTITUTION, AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

20 U.S.C. § 1078(c)(1)(A) (1986 Supp.)

(c) Guaranty agreements for reimbursing losses

(1) Authority to enter into agreements

(A) The Secretary may enter into a guaranty agreement with any guaranty agency, whereby the Secretary shall undertake to reimburse it, under such terms and conditions as the Secretary may establish, with respect to losses (resulting from the default of the student borrower) on the unpaid balance of the principal and accrued interest of any insured loan, including the administrative costs of supplemental preclaim assistance for default prevention as defined in paragraph (6)(C). The guaranty agency shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement according to the provisions of this subsection. Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in paragraph (7), the amount to be paid a guaranty agency as reimbursement under this subsection shall be equal to 100 percent of the amount expended by it in discharge of its insurance obligation incurred under its loan insurance program. In no case shall a guaranty agency file a claim under this subsection for reimbursement with respect to losses prior to 270 days after the loan becomes delinquent with respect to any installment thereon.

PUB. L. NO. 100-203, 101 STAT. 1330-36

SEC. 3001. RECOVERY OF EXCESS CASH RESERVES ACCUMULATED UNDER THE GUARANTEED STUDENT LOAN PROGRAM

(a) IN GENERAL—Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is amended by adding at the end thereof the following new subsection:

"(e) REDUCTION OF EXCESS CASH RESERVES.—

"(1) LIMITATION ON MAXIMUM CASH RESERVES—A guaranty agency shall not accumulate cash reserves in excess of the greater of—

"(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;

"(B) 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;

"(C) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount;

"(D) $500,000; or

"(E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

"(2) RECOVERY OF EXCESS CASH RESERVES.—The Secretary shall, not later than March 31, 1988, determine for each guaranty agency the maximum cash reserve permitted under paragraph (1) for fiscal year 1986. Subject to paragraphs (3) and (4), if the Secretary determines that any guaranty agency had, at the end of fiscal year 1986, a cash

reserve that exceeded such maximum, the Secretary shall direct the agency to eliminate such excess by any one or more of the following methods, as selected by the guaranty agency:

"(A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d);

"(B) by withholding and canceling claims for reimbursement otherwise payable under section 428(c)(1);

"(C) by reducing the amount of payments for which application will be made by such agency under section 428(f); or

"(D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees in addition to the fees required by section 428(c)(9), as proposed by the agency and agreed to by the Secretary.

"(3) APPEALS BASED ON SPECIAL CIRCUMSTANCES.—(A) If the Secretary determines, on the basis of an application from a guaranty agency, that—

"(i) the agency's financial position has deteriorated significantly since the end of the preceding fiscal year;

"(i) significant changes in the economic circumstances (such as a change in agency current cash reserves) or the loan insurance program render the limitations of paragraph (1) inadequate for the continued functioning of the agency; or

"(iii) in recovering funds as required by this subsection, a guaranty agency would be compelled to violate contractual obligations existing on the date

of enactment of this subsection that require a specified level of reserve funds to be maintained by such agency;

the Secretary may waive, in whole or in part, the imposition of the remedies required by paragraph (2) for such agency.

"(B) The Secretary shall respond to request for waivers from guaranty agencies in an expedited manner and, except for unusual circumstances or with the consent of the guaranty agency, shall resolve such request within 6 weeks of submission.

"(4) RECOVERY LIMITS. - The Secretary shall not require a total reduction of cash reserves for all guaranty agencies in excess of $250,000,000 during fiscal year 1988. If the total of cash reserves of all guaranty agencies exceeds the maximum amounts permitted under paragraph (1) by more than $250,000,000, the Secretary shall ratably reduce the amounts that guaranty agencies are directed to eliminate under paragraph (2), so that the total excess cash reserves to be eliminated equals $250,000,000.

"(5) DEFINITIONS.—As used in this subsection—

"(A) the 'cash reserves' for any guaranty agency for any fiscal year are equal to the agency's cumulative cash receipts less the agency's cumulative cash disbursements at the end of such fiscal year;

"(B) the 'total reserves' for any guaranty agency for any fiscal year are equal to the agency's cash reserves plus the agency's cumulative accounts receivable less the agency's accounts payable, as of the end of such fiscal year;

"(C) the term 'cumulative cash receipts' includes such receipts as insurance premiums, Federal reinsurance payments, and collections on defaulted loans;

"(D) the term 'cumulative cash disbursements' includes such disbursements as payments for default claims, repayment of Federal advances, transfers to other State activities, and payment of collection costs and other operating costs;

"(E) the term 'accounts receivable' includes Federal reinsurance payments and administrative cost allowances owed but not yet paid to the guaranty agency, as of the end of a fiscal year; and

"(F) the term 'accounts payable' includes collections and reinsurance fees due (but not paid) to the Department of Education, as of the end of a fiscal year.".

(b) CONFORMING AMENDMENTS.—

(1) The second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

(2) Section 428(c)(9)(A) of such Act is amended by striking out "an amount equal to" and inserting "an amount, subject to section 422(e), equal to".

(3) The second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

SEC. 3002. REPEAL

(a) IN GENERAL.—Subsection (e) of Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is repealed on September 30, 1989.

(b) CONFORMING AMENDMENTS.—

(1) Effective September 30, 1989, the second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

(2) Effective September 30, 1989, section 428(c)(9)(A) of such Act is amended by striking out "an amount, subject to section 422(e), equal to" and inserting "an amount equal to".

(3) Effective September 30, 1989, the second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

34 C.F.R. § 682.410(a) (1988)

FISCAL, ADMINISTRATIVE AND ENFORCEMENT REQUIREMENTS

(a) *Fiscal requirements.* A guarantee agency shall establish, at a minimum, the following fiscal procedures:

(1) The guarantee agency shall establish and maintain a reserve fund to which the guarantee agency shall credit—

(i) Federal advances obtained under, and matching funds required by, section 422(a) of the Act;

(ii) Funds appropriated by a State for the agency's loan guarantee program;

(iii) Federal advances obtained under § 682.403;

(iv) Funds received by the guarantee agency as loan insurance premiums;

(v) Administrative cost allowances received by the guarantee agency under § 682.407;

(vi) Funds received by the guarantee agency for the agency's loan guarantee program from gift, grant, or other sources;

(vii) Funds collected on defaulted loans;

(viii) Death, disability, bankruptcy, and reinsurance payments received from the Secretary; and

(ix) Funds earned from investments under paragraph (a)(5) of this section.

(2) Except as provided in paragraphs (a)(3) and (a)(4) of this section, a guarantee agency may use the assets of the reserve fund established under paragraph (a)(1) of this section only to—

(i) Guarantee loans under the guarantee agency's loan guarantee program;

(ii) Pay default claims;

(iii) Pay death, disability, and bankruptcy claims;

(iv) Refund overpayments of insurance premiums;

(v) Pay to the Secretary the Secretary's equitable share of borrower payments; and

(vi) Repay advances made by the Secretary.

(3) Except as provided in paragraph (a)(4) of this section, a guarantee agency may also use loan insurance premiums, administrative cost allowances, interest or investment earnings, and funds described in paragraph (a)(1)(vi) of this section for payments necessary for the proper administration of the guarantee agency's loan guarantee program.

(4)(i)The guarantee agency may use the amount of Federal advances identified in paragraph (a)(1)(iii) of this section, and interest or other earnings on those advances, only to pay default claims.

(ii) The guarantee agency shall account separately for the funds described in paragraph (a)(4)(i) of this section.

(5) The guarantee agency may invest the assets of the reserve fund described in paragraph (a)(1) of this section only in low-risk securities, such as obligations issued or guaranteed by the United States or a State, and shall exercise the level of care in that investment required of a fiduciary charged with the duty of investing the money of others.

(6) If the guarantee agency uses loan insurance premiums or funds earned from investments under paragraph (a)(5) of this section to buy an asset and—

(i) If the agency subsequently sells that asset, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the sale proceeds equal to the percentage of the original purchase price of the asset paid with the insurance premiums and investment earnings; or

(ii) If the agency subsequently converts the asset to a use unrelated to its GSLP or PLUS loan guarantee program, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the fair market value of the asset equal to the percentage of the original purchase price paid with the insurance premiums or investment earnings.

Supreme Court, U.S.
FILED
JUL 23
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 89-1873

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

MARYLAND HIGHER EDUCATION LOAN CORPORATION,
Petitioner,

v.

LAURO F. CAVAZOS, SECRETARY OF THE UNITED STATES DEPARTMENT OF EDUCATION, *et al.*,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Petitioner Maryland Higher Education Loan Corporation ("MHELC") submits this supplemental brief to call the Court's attention to important developments that occurred after the filing of MHELC's Petition for Writ of Certiorari. *See* Sup. Ct. R. 15.7. Since that filing, four other student loan guaranty agencies have filed certiorari petitions with this Court seeking review of the same question presented in MHELC's petition. *See South Carolina State Education Assistance Authority v. Lauro F. Cavazos*, No. 89-2027; *North Carolina v. United States*, No. 90-4;

Ohio Student Loan Commission v. Lauro F. Cavazos, No. 90-13; and *Education Assistance Authority v. Lauro F. Cavazos*, No. 90-84.

Presently, therefore, five of the twenty-six guaranty agencies challenging the constitutionality of the 1987 Amendments to the Higher Education Act of 1965 ask this Court to decide whether those amendments authorize the confiscation of private property in violation of the Fifth Amendment. Review is warranted to resolve this important constitutional question.

Respectfully submitted,

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v.

LAURO F. CAVAZOS, SECRETARY OF EDUCATION, ET AL.

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY, PETITIONER

v.

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STATE OF NORTH CAROLINA, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

Section 3001 of the Omnibus Budget Reconciliation Act of 1987 (OBRA), 20 U.S.C. 1072(e) (repealed), amended provisions of the Guaranteed Student Loan Program (GSLP) created by the Higher Education Act of 1965. Section 3001 required agencies that guaranty GSLP loans to transfer "excess" GSLP cash from their reserve funds to the Secretary of Education, for deposit into the general GSLP fund maintained by the Secretary for reimbursement purposes. Section 3001 also made the guaranty agencies' right to receive federal reimbursement for losses subject to their compliance with the transfer requirement. Section 3001 has been challenged on the ground that it violates the Takings Clause of the Fifth Amendment. The questions presented are:

1. Whether the guaranty agencies had "private property" rights to the excess cash within the meaning of the Takings Clause.

2. Whether Section 3001 "took" the guaranty agencies' "vested right" to reimbursement under pre-OBRA contracts between the agencies and the Secretary.

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-11a) [1] in these consolidated cases is reported at 897 F.2d 1272. The district court opinion in the Maryland case (89-1873 Pet. App. 17a-19a) is unreported. The opinion of the district court in the South Carolina case (89-2027 Pet. App. 19a-39a) is reported at 716 F. Supp. 886. The opinion of the district court in the North Carolina case (90-4 Pet. App. 15a-22a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 7, 1990. Petitions for rehearing were denied on March 28, 1990. Pet. App. 12a-14a. The petition for a writ of certiorari in No. 89-1873 was filed on June 1, 1990. The petition in No. 89-2027 was filed on June 22, 1990. The petition in No. 90-4 was filed on June 26, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. The Higher Education Act of 1965 (the Act), 20 U.S.C. 1071, established the Guaranteed Student Loan Program (GSLP). In that program, public and private lending institutions make low-interest, higher-education loans, subsidized by the federal government, to students. State and nonprofit private agencies that participate in the GSLP must execute an "insurance program agreement" with the Secretary in which the agencies promise to oper-

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[1] Unless otherwise noted, we will use "Pet. App." to refer to the appendix to the petition in No. 89-1873. We will refer to the petitioner in No. 89-1873 as the "Maryland petitioner," to the petitioner in No. 89-2027 as the "South Carolina petitioner," and to the petitioners in No. 90-4 as the "North Carolina petitioner."

ate a student loan insurance program that meets GSLP requirements and to guarantee lenders they will pay 100% of the unpaid principal on a qualifying student loan in case of default or other failure to repay. 20 U.S.C. 1078(b); 34 C.F.R. 682.410, 682.411. The agreements specify that the state agency agrees "to be bound by all changes in the Act or regulations in accordance with their effective dates," Pet. App. 8a, and the regulations similarly provide that "[a]ll of the agreements are subject to subsequent changes in the Act or the regulations that apply to the GSLP * * *." 34 C.F.R. 682.400(d). In return, the Secretary agrees to make interest subsidy payments, on behalf of students, to lenders whose loans are guaranteed by the agency. *Id.* at 269a. The Act authorizes the Secretary to pay "special allowances" to the lenders, so that their return is not "less than equitable." 20 U.S.C. 1087-1(a). See Pet. App. 5a.

The Higher Education Act of 1965 also authorizes the Secretary to enter into a "guaranty agreement" with a participating state guaranty agency in which the Secretary agrees to reimburse the state guaranty agency for losses resulting from the default of a student borrower on the unpaid balance of the principal and accrued interest of any GSLP loan. 20 U.S.C. 1078(c)(1)(A).[2] The amount of re-

[2] Before 1976, guaranty agencies were required to insure only 80% of the principal amount of covered loans, and the Commissioner of Education was authorized to enter into "reinsurance agreement[s]" with them in which the Commissioner would undertake to reimburse 80% of the agencies' guaranty losses. See 34 C.F.R. 682.404(a)(1). Under the Education Amendments of 1976, Pub. L. No. 94-482, 90 Stat. 2114, 2120, the Commissioner was authorized to enter into "supplemental reinsurance agreements" with agencies that insured 100% of their covered loans, in which the Commissioner would undertake to reimburse 100% of their guaranty losses if they had an overall default rate below 5% of the principal amount of all loans; 90% if the default rate was between 5% and 9%; and 80% if the default rate exceeded

imbursement ranges between 80% and 100% of the amount expended by the agency in discharge of its guaranty obligations, depending on the agency's overall default rate. Since 1986 guaranty agencies have been required to pay a reinsurance fee to the Secretary, equal either to 0.25% of the total principal amount of covered loans guaranteed by the agency that year, or 0.5% if the agency's overall default rate exceeded 5%. 20 U.S.C. 1078(c)(9). See Pet. App. 5a.

As amended in 1986, the Higher Education Act of 1965 states that a participating state guaranty agency is "deemed to have a contractual right against the United States" during the life of each GSLP loan "to receive reimbursement" according to the provisions of that Act. Higher Education Amendments of 1986, Pub. L. No. 99-498, 100 Stat. 1381 (codified at 20 U.S.C. 1078(c)(1)(A)). The guaranty agreement, however, like the insurance program agreement, obliges each state guaranty agency to comply with "all changes in the Act or Regulations in accordance with their effective dates." C.A. App. 24a, 28a, 141a-142a, 148a-149a, 270a, 275a; see Pet. App. 8a. The guaranty agreement also provides that the Secretary may withhold or demand compensation for federal payments—including reimbursements—if the state guaranty agency fails to comply with the Act or its implementing regulations. *Id.* at 26a, 31a-32a, 145a-146a, 152a, 270a-271a, 278a.

9%. See 34 C.F.R. 682.405. Under the Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a) 100 Stat. 1371, all guaranty agencies must insure 100% of their covered loans, and the reimbursement rate is the same as the Commissioner undertook in the supplemental reinsurance agreements. Since 1986 the "reinsurance" and "supplemental reinsurance" agreements have been referred to collectively as "guaranty agreements."

The Higher Education Act of 1965 authorizes or provides for other sources of revenue to state guaranty agencies. It authorizes the Secretary to make cash advances to help establish or strengthen such agencies, 20 U.S.C. 1072(a)(1); it permits such agencies to collect a single insurance premium from lenders of not more than 3% of the principal amount of a loan, 20 U.S.C. 1078(b)(1)(H); it permits such agencies to retain 30% of amounts they collect from defaulting borrowers after reinsurance payments have been made to them, 20 U.S.C. 1078(c)(2)(D) and (c)(6)(A)(ii);[3] and it directs the Secretary to pay (and provides that guaranty agencies shall "be deemed to have a contractual right against the United States to receive") a portion of the agencies' administrative costs, 20 U.S.C. 1078(f)(1)(A) and (B). Pet. App. 5a.

Under the Secretary's regulations, state guaranty agencies must deposit reimbursements, revenue authorized or provided by the Act, and all state appropriations, gifts, grants, and investment earnings, into a "reserve fund." 34 C.F.R. 682.410(a)(1). The regulations stipulate that none of the money in the reserve fund may be used for purposes other than GSLP purposes specified by the Secretary: namely, guaranteeing loans, paying claims, refunding overpayments and advances, and administering the program. 34 C.F.R. 682.410(a)(2)-(6).

b. A major problem with the GSLP has been the increasing accumulation and use of cash in the guaranty agencies' reserve funds. In a 1986 report commissioned by Congress, the Comptroller General found that state guar-

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[3] Under 20 U.S.C. 1078(c)(8), a state guaranty agency must assign to the Secretary any loan for which the Secretary has made a reimbursement payment if the Secretary determines that is required to protect the federal fiscal interest. When such an assignment is made, the agency may not retain any portion of the collections. 34 C.F.R. 682.409(b).

anty agencies had accumulated huge cash reserves that "exceed the risks guarant[y] agencies are asked to assume [at the] expense of the federal government and student borrowers." C.A. App. 380a. The Comptroller General also found that at least some agencies were using the reserves for improper purposes. *Id.* 381a-383a. The Comptroller General recommended, among other things, that Congress set limits on the amount of cash guaranty agencies could retain in their reserve funds, to correspond to the actual financial risks they face. *Id.* at 408a-409a. The Comptroller General later submitted a report to Congress with draft guidelines for establishing maximum cash reserve levels. *Id.* at 434a-471a.

c. On December 22, 1987, Congress enacted the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (the 1987 OBRA Amendments). Section 3001 of OBRA amended several GSLP provisions of the Higher Education Act of 1965. 20 U.S.C. 1072(e) (repealed).[4] Under Section 3002 of the 1987 OBRA Amendments, 101 Stat. 1330-38, the provisions of Section 3001 were scheduled to, and did, expire on September 30, 1989.

The 1987 OBRA Amendments required the Secretary to determine the "maximum cash reserve[ ]" permitted each guaranty agency for fiscal year 1986 under a statutory formula based on the Comptroller General's draft guidelines. 20 U.S.C. 1072(e)(1) (repealed).[5] If the Secretary deter-

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[4] In the legislative history of the OBRA, Section 3001 appears for the first time in the conference committee report. H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. 39-41 (1987).

[5] The maximum level was the greater of "(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year; (B) 0.3 percent of the original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year; (C) an amount which, when combined with

mined that any guaranty agency had, at the end of fiscal year 1986, cash reserves in excess of its "maximum," the Secretary was required to direct the agency to "eliminate" the excess by one or more of the following methods: (a) repaying advances of federal funds made by the Secretary to the agency and not otherwise required to be repaid; (b) withholding and canceling reimbursement claims otherwise payable by the Secretary to the agency; (c) reducing the amount of administrative cost allowances for which the agency otherwise would apply to the Secretary; and (d) any other method of reducing payments from, or increasing payments to, the federal government. 20 U.S.C. 1072(e)(2) (repealed). The 1987 OBRA Amendments also included provisions to enforce the transfer requirement. Those provisions made the state guaranty agencies' statutory "contractual right" to receive reimbursements and administrative cost allowances from the Secretary "subject to" the agencies' compliance with the transfer requirement. 20 U.S.C. 1078(c)(1)(A) and (f)(1)(B) (repealed).[6]

The 1987 Amendments allowed the Secretary to waive the requirement to eliminate excess cash reserves if he determined that an agency's financial position had deteriorated significantly since the end of the preceding fiscal year, that significant changes in economic circumstances or the agency's loan insurance program rendered the maximum reserve level inadequate for the continued function-

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all other parts of total agency reserves, equals 0.4 percent of such original principal amount; (D) $500,000; or (E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986." 20 U.S.C. 1072(e)(1) (repealed).

[6] Similarly, the 1987 Amendments made the amount of the reinsurance fee paid by agencies to the Secretary "subject to" the transfer requirement. 20 U.S.C. 1078(c)(9)(A) (repealed). That allowed agencies to increase the fee in satisfaction of that requirement. See 20 U.S.C. 1072(e)(2)(D) (repealed).

ing of the agency, or that in eliminating the excess cash reserves the agency would violate contractual obligations on the date the 1987 OBRA Amendments were enacted requiring the agency to maintain a specific level of reserve funds. 20 U.S.C. 1072(e)(3) (repealed). The Amendments also set a nationwide limit of $250 million on the amount of excess cash reserves to be eliminated. 20 U.S.C. 1072(e)(4) (repealed).

All excess cash transferred to the Secretary by guaranty agencies under the 1987 Amendments was deposited in the GSLP student loan insurance fund maintained by the Secretary under 20 U.S.C. 1081. C.A. App. 377a. That fund is used to make reimbursement payments to guaranty agencies, as well as to make payments for defaulted loans insured directly by the Secretary. *Ibid.*

2. As required by the 1987 OBRA Amendments, the Secretary calculated the statutory "maximum cash reserve" for the Maryland, South Carolina, and North Carolina petitioners. The Secretary concluded that each one had excess cash reserves, and directed each petitioner to transfer that excess to the federal government.[7] After each peti-

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[7] After calculating the Maryland petitioner's maximum cash reserve, the Secretary informed it that it was required to transfer $10,797,400 in excess cash reserves. Pet. App. 7a. The Maryland petitioner had certified cash reserves of $22,554,507, and its "maximum cash reserve" was $10,384,151. C.A. App. 182a. The amount of excess cash reserves petitioners were directed to transfer was calculated by subtracting the "maximum" from the amount certified, further subtracting an amount owed to the Secretary under a different statute, and ratably reducing the result to comply with the $250 million nationwide ceiling on the recovery of excess cash reserves. The Maryland petitioner applied for, but was denied, a waiver of the transfer requirement. Pet. App. 7a. That denial was not challenged in the courts below.

The Secretary determined the South Carolina petitioner's maximum cash reserve, and he informed it that it was required to transfer

tioner refused to comply with the Secretary's directive, the Secretary withheld GSLP reimbursements otherwise payable to each petitioner until the full amount was recovered. Pet. App. 7a.

Petitioners filed separate suits in different district courts challenging the Secretary's actions. The courts in Maryland and South Carolina held that the 1987 OBRA Amendments were unconstitutional and enjoined their enforcement.[8]

$2,739,528 of its excess cash reserves. Pet. App. 6a. The South Carolina petitioner had certified cash reserves of $3,633,720, and a "maximum cash reserve" of $500,000. C.A. App. 94k. The South Carolina petitioner applied for, but was denied, a waiver of the transfer requirement. The South Carolina petitioner challenged the denial of the waiver in the district court, but the district court did not decide that question. 89-2027 Pet. App. 38a-39a n.9.

The Secretary determined the North Carolina petitioner's maximum cash reserve, and he informed it that it was required to transfer $15,911,946 of its excess cash reserves. Pet. App. 7a. The North Carolina petitioner had certified cash reserves of $18,646,346, and a "maximum cash reserve" of $1,421,534. C.A. App. 308a-310a. The North Carolina petitioner applied for a waiver, and the Secretary waived $13,279,161 of the amount due, based on 20 U.S.C. 1072(e)(3)(A)(iii) (repealed). C.A. App. 313a-316a. The North Carolina petitioner did not challenge the Secretary's waiver decision.

[8] In the South Carolina case, the district court held that under the guaranty agreement and the statute deeming state guaranty agencies to have a "contract[ ] right" to receive reimbursements, the South Carolina petitioner acquired "vested property rights" to reimbursements, and that the 1987 Amendments violated the Fifth Amendment by "tak[ing] away that property." 89-2027 Pet. App. 37a. The Secretary had argued that the agreement requiring the South Carolina petitioner to comply with "all changes in the Act or Regulations" defeated any claim of "vested" rights. The court rejected that argument on the ground that the reservation was ineffective since it did not appear in the Higher Education Act of 1965 itself. 89-2027 Pet. App. 34a-37a. The court enjoined the Secretary from enforcing the 1987 OBRA Amendments against the South Carolina petitioner, and ordered him

By contrast, the North Carolina court upheld the Amendments.[9]

The Secretary appealed from the Maryland and South Carolina judgments, and his appeals were consolidated with an appeal in the North Carolina case.[10] The court of appeals reversed the judgments in the Maryland and South Carolina cases and upheld the judgment in the North Carolina case.

The court of appeals rejected the argument that the 1987 OBRA Amendments could not modify the guaranty agree-

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to release to it the reimbursements he had withheld. *Ibid.*

The Maryland district court adopted the decision of the South Carolina district court, holding that the amendments were an uncompensated taking of the Maryland petitioner's right to reimbursement. Pet. App. 19a. The court stated that "[i]n a nutshell, the excess cash reserves are the property of the plaintiff, and despite language making the plaintiff's contract with the defendants conformable to legislative changes, the federal government cannot simply take the cash reserves away from the plaintiff." *Ibid.*

[9] The North Carolina district court held that the North Carolina petitioner "has none of the essential 'private property' rights over the money in its [reserve fund], including the excess cash reserves." 90-4 Pet. App. 20a. The court reasoned that "once [the North Carolina petitioner] executed its GSLP agreements with the Department of Education and agreed to abide by the Higher Education Act and its regulations, it necessarily relinquished any 'ownership' claim to funds it thereafter would be permitted to receive and retain for GSLP purposes." *Ibid.* The court also observed that the North Carolina petitioner was prohibited by the Secretary's regulations "from using *any* of the money in its reserve fund for purposes other than the GSLP purposes specified by the Secretary." *Id.* at 21a. Since "the federal government has control over most of the sources and all of the uses of [the North Carolina petitioner's reserve fund]," the district court held, "the excess cash reserves which are the subject of this action are not 'private property,' but public property, and as such are not entitled to Fifth Amendment protection." *Id.* at 22a.

[10] The court of appeals stayed the final judgments in the Maryland and South Carolina cases pending disposition of the consolidated appeals.

ments because the Higher Education Act of 1965 did not expressly reserve to the federal government the right to modify agreements executed under that Act. Relying on *Bowen* v. *Public Agencies Opposed to Social Security Entrapment* (*POSSE*), 477 U.S. 41, 52-53 (1986), the court held that the power to modify contractual arrangements is reserved unless it is expressly relinquished. Pet. App. 8a. For that reason, the court held, Congress had the authority to modify the federal government's obligations under the GSLP guaranty agreements. *Id.* at 8a-9a.

The court of appeals then held that the 1987 OBRA Amendment requirement that state guaranty agencies transfer excess reserves to the Secretary did not "take" the agencies' "private property" in violation of the Fifth Amendment Takings Clause, because the agencies did not have "private property" rights to the excess reserves. Pet. App. 9a-10a. The court reasoned that "[i]f property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, then it loses its character as 'private' property, and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment." *Id.* at 9a. Since the Secretary's regulations "completely control the reserve funds' uses," the court of appeals reasoned, those regulations were "the sort of 'existing rules or understandings' which prevent any of the guaranty agencies from acquiring an ownership interest in its reserve fund which would entitle it to protection as private property under the Takings Clause." *Id.* at 10a.

The court of appeals also rejected the argument that the "private property" at issue was the guaranty agencies' "vested contractual rights to receive reimbursement payments," and that the enforcement provision of the 1987 OBRA Amendments, which empowered the Secretary to withhold reimbursements from noncomplying agencies,

takes that "property." Pet. App. 10a. The court noted that a clause in the guaranty agreements required every guaranty to comply with "all changes in the Act or regulations in accordance with their effective dates" as a condition of receiving reimbursement. *Id.* at 11a. That clause, the court explained, expressly put the agencies on notice that the Higher Education Act of 1965 could be amended in the future. *Id.* at 10a. Because Congress had not expressly relinquished its amendment power, the court stated, the contractual reservation was effective. *Id.* at 8a-9a. The court of appeals concluded that "the public nature of the reserve funds themselves," which include "reimbursement payments destined for inclusion in such reserve funds," when "coupled with the express contractual reservation of the power to amend the terms of the GSL program and the fact that the legislative changes involve a comprehensive federal/state social welfare program, forecloses a finding that the state agencies have obtained unalterable vested property rights to certain payments." *Id.* at 11a.

ARGUMENT

Petitioners have sought review of the court of appeals' judgment upholding the constitutionality of Section 3001 of the 1987 OBRA Amendments to the Higher Education Act of 1965 against a challenge based on the Takings Clause of the Fifth Amendment. The decision below, however, does not warrant review by this Court, for several reasons.

1. There is no conflict among the circuits on the questions presented. The Fourth Circuit's decision in this case is fully consistent with the Sixth Circuit's decision in *Ohio Student Loan Comm'n* v. *Cavazos*, 900 F.2d 894 (1990), petition for cert. pending, No. 90-13, and the Eighth Circuit's decision in *Education Assistance Corp.* v. *Cavazos*, 902 F.2d 617 (1990), petition for cert. pending, No. 90-84,

both of which also upheld the 1987 OBRA Amendments against identical constitutional challenges.[11]

2. The questions presented by this case are of no continuing importance. The amendments to the Higher Education Act of 1965 that gave rise to this litigation were enacted as Section 3001 of the 1987 OBRA Amendments. An accompanying provision of the 1987 OBRA Amendments, Section 3002, however, stated that the provisions of Section 3001 would expire on September 30, 1989. Section 3001 was not extended and therefore expired on that date. Moreover, no similar legislation has been introduced in Congress. Accordingly, the questions presented by this case are of only historical interest, and review by this Court is not warranted.

3. The decision below is also correct. The Fourth Circuit correctly held that Section 3001 of the 1987 OBRA Amendments did not violate the Takings Clause because petitioners did not have "private property rights" in regard to the excess in their reserve funds, and because withholding reimbursement did not unconstitutionally abrogate petitioners' "contract" rights. Accord *Education Assistance Corp.* v. *Cavazos*, 902 F.2d at 626-630; *Ohio Student Loan Comm'n* v. *Cavazos*, 900 F.2d at 898-902.

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[11] District courts in the First, Second, Third, Seventh, and Eleventh Circuits have also upheld the 1987 Amendments against identical challenges. *Maine State Bd. of Educ.* v. *Cavazos*, Civil No. 88-0273 (D. Me. July 25, 1990); *Conn. Student Loan Foundation* v. *Cavazos*, No. H89-182 (D. Conn. Jan. 10, 1990), appeal withdrawn by stipulation, No. 90-6111 (2d Cir. June 18, 1990); *Delaware* v. *Cavazos*, 723 F. Supp. 234 (D. Del. 1989), appeal pending, No. 90-3339 (3d Cir. docketed May 30, 1990); *Great Lakes Higher Educ. Corp.* v. *Cavazos*, 711 F. Supp. 485 (W.D. Wis. 1989), appeal pending, No. 89-2748 (7th Cir. argued May 15, 1990); *Georgia Student Finance Comm'n* v. *Cavazos*, No. 1:89-cv-160-MHS (N.D. Ga. July 9, 1990). Ten other suits challenging the constitutionality of the 1987 OBRA Amendments are pending in various district courts. 89-1873 Pet. 13-14 n.5.

a. "Private property" is property as to which the claimant has the rights of "free use, enjoyment, and disposal." *Buchanan* v. *Warley*, 245 U.S. 60, 74 (1917). Such rights "are created and their dimensions are defined by existing rules or understandings that stem from an independent source," such as pertinent statutes and regulations. *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1001 (1984). Although the Takings Clause protects "private property" owned by a state, *United States* v. *50 Acres of Land*, 469 U.S. 24 (1984), under the GSLP 'aws and regulations, the amounts in petitioners' reserve funds are not properly characterized as their "private property," for several reasons.

First, the federal government is the direct source of or the indispensable catalyst for virtually all the cash in petitioners' reserve funds. For example, during the period of time the Maryland petitioner's excess cash reserves were determined, its reserve fund deposits consisted of reimbursements, administrative cost allowances, insurance premiums from lenders, and a portion of the collections from defaulting borrowers on loans for which the Secretary had already made reimbursement payments.[12] Those reimbursements and administrative cost allowances came directly from the federal government. The insurance

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[12] The record shows that from October 1, 1986, through September 30, 1988, the Maryland petitioner received a total of $75,560,690, of which $47,901,314 came from federal reimbursements; $2,888,694 came from federal administrative cost allowances; $16,206,870 came from the portion of collections on defaulted loans that the Secretary allowed the Maryland petitioner to retain; and $4,370,791 came from insurance premiums paid by lenders. C.A. App. 191a, 207a. The remaining $4,193,021 came from the investment of the reserve fund cash in Treasury or other federally-approved securities. *Ibid.* Thus, the Maryland petitioner's statement that its cash reserves "were derived entirely from non-federal sources," 89-1873 Pet. 10, is palpably incorrect.

premiums came from lenders induced to participate in the GSLP by federally-backed loan guarantees, federal interest subsidies, and federal special allowances. The collections were give-backs from the federal government of amounts to which the Secretary was entitled by virtue of his reimbursement payments, and which he could have kept for himself by demanding assignment of the underlying loans. Pp. 3-5 & n.5, *supra*. Second, all of the cash in petitioners' reserve funds must be used for GSLP purposes specified by the Secretary; none of it lawfully can be used for any other purpose. 34 C.F.R. 682.410(a)(2).[13] Thus, the court of appeals properly concluded that petitioners could not freely use, enjoy, and dispose of the cash in their reserve funds. For those reasons, the court properly held that the Fifth Amendment does not prohibit the compulsory transfer of some of this cash from petitioners' individual reserve funds to the general GSLP fund.[14]

The court of appeals' holding also raises no significant issue of federalism. Petitioners are creatures of state law

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[13] The Maryland petitioner asserts that the regulation prohibiting the use of reserve fund cash for non-GSLP purposes "did not even come into existence until 1986." 89-1873 Pet. 10 n.1. That is not true. Before 1986, the same use restriction applied, but in literal terms it applied only to agencies which were holding federal advances paid under 20 U.S.C. 1072. The Maryland petitioner was such an agency. C.A. App. 94h. In 1986, the Secretary clarified the regulation in order to make it applicable to all guaranty agencies regardless of whether they were holding federal advances. 51 Fed. Reg. 40,886, 40,909 (1986).

[14] The decision below does not conflict with *CIR* v. *Lincoln Savings & Loan Ass'n*, 403 U.S. 345 (1971), as the Maryland petitioner claims. 89-1873 Pet. 10. The question in that case was whether an additional premium paid by a state-chartered savings and loan association to the Federal Savings and Loan Insurance Corporation was deductible as an ordinary and necessary business expense under the Internal Revenue Code. 403 U.S. at 345-346. That case did not involve a takings question.

and were required by state law to establish reserve funds. But once they voluntarily executed insurance program and guaranty agreements binding themselves to comply with GSLP statutory and regulatory requirements, petitioners relinquished any claim of ownership to federally donated or generated cash that they would receive and deposit in those funds. Even the state laws cited by the South Carolina and North Carolina petitioners recognize that the cash in the reserve funds is held by petitioners as trustees, to be used exclusively for GSLP purposes. S.C. Code Ann. § 59-115-110 (Law. Co-op 1972) (*reprinted at* 89-2027 Pet. App. 54a); N.C. Gen. Stat. § 116-204(6) (1987); *Durham* v. *McLeod*, 259 S.C. 409, 413, 192 S.E.2d 202, 204 (1972); *State Educ. Assistance Auth.* v. *Bank of Statesville*, 276 N.C. 576, 591, 174 S.E.2d 551, 562 (1970).

This Court's decision in *Dayton-Goose Creek Ry.* v. *ICC*, 263 U.S. 456 (1924), is instructive in this regard. That case involved a challenge under the Takings Clause to the Transportation Act of 1920, ch. 91, § 15a, 41 Stat. 489-491. The Transportation Act fixed a maximum 6% rate of return for carriers engaged in interstate commerce, required carriers to transfer any excess return equally to a reserve fund to be maintained by each carrier and to a general railroad revolving fund to be maintained by the Interstate Commerce Commission. Revenues placed in those reserve funds could generally be used only for specific purposes, such as paying interest on bonds or other securities, paying rent on leased railroad lines, paying dividends, and making loans to other carriers to meet expenses. *Dayton-Goose Creek Ry.*, 263 U.S. at 476-477. This Court rejected the railroads' claim that the statute took their property without just compensation. The Court reasoned that the Act made a carrier "only a trustee for the excess over a fair return received by it," *id.* at 484, and that, since the railroads were guaranteed a fair return, it was not unreason-

able to require them to contribute to a fund designed to help the "weaker" carriers, *id.* at 484-485. In this case, state guaranty agencies also have a role akin to that of a trustee, since they administer funds that flow in and out of the GSLP. *Education Assistance Corp.* v. *Cavazos*, 902 F.2d at 627; *Ohio Student Loan Comm'n* v. *Cavazos*, 900 F.2d at 899. As the Sixth Circuit put it, "the Secretary is transferring the funds from a federal program with a state administrator, not a state program." *Ibid.* Under these circumstances, Section 3001 of the 1987 OBRA Amendments does not take petitioners' property interest in excess reserves.

b. There is also no merit to petitioners' argument that the Secretary unconstitutionally took their property by not reimbursing petitioners in accordance with the reimbursement agreements that petitioners had executed with the Secretary before the 1987 OBRA Amendments became law.[15] Petitioners' claim rests on the assumption that they had a contractual (and therefore a property) interest in a rate of reimbursement that could not be affected by subsequent legislation. That assumption, however, is mistaken.

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[15] Once the court of appeals decided (correctly) that the petitioners did not have a "private property" right in excess cash reserves, the court did not have to reach the other question petitioners present: namely, whether the enforcement provision of the 1987 OBRA amendments, which made the receipt of reimbursements subject to compliance with the transfer requirement, unconstitutionally took petitioners' contractual rights to those reimbursements. Instead, the court could have upheld the Secretary's withholding of petitioners' reimbursements on the basis of petitioners' guaranty agreements, which expressly authorize the Secretary to withhold reimbursements due to an agency's failure to comply with federal law. C.A. App. 26a, 31a-32a, 145a-146a, 152a, 270a-271a, 2678a. In any event, the court of appeals correctly held that petitioners have no "vested" or "property" rights under their guaranty agreements in reimbursement.

Petitioners rely on the terms of the reimbursement agreements they had previously executed with the Secretary. 89-1873 Pet. 5; 89-2027 Pet. 13-14; 90-4 Pet. 4-5, 16-23. The very text of those agreements, however, makes clear that petitioners' right to reimbursement is contingent; it is expressly conditioned on petitioners' compliance with whatever provisions of the Higher Education Act of 1965 and its implementing regulations are currently in force, whether those provisions existed when the underlying loans were made or, as in the case of the 1987 OBRA Amendments, were added by subsequent amendment. Because the contingency was spelled out in the agreements, it was effective against petitioners even though the Higher Education Act of 1965 does not contain express terms reserving Congress's power to amend its provisions. *Miller* v. *The State*, 82 U.S. (15 Wall.) 478, 495, 497 (1872). See *Stockholders* v. *Sterling*, 300 U.S. 175, 183 (1937); *Looker* v. *Maynard*, 179 U.S. 46, 52 (1900). See generally *POSSE*, 477 U.S. at 51-54. As this Court explained in *POSSE*, 477 U.S. at 52 (quoting *Merrion* v. *Jicarilla Apache Tribe*, 455 U.S. 130, 147, 148 (1982)), "contractual arrangements, including those to which a sovereign itself is party, 'remain subject to subsequent legislation' by the sovereign," because "sovereign power, even when unexercised is an enduring presence that governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." Accordingly, the reimbursement agreements did not guarantee petitioners immunity from subsequent changes in the GSLP, as they claim. Quite the contrary, the agreements were expressly subject to such changes.

Petitioners' claim to a contractual right to reimbursement also rests on the Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1376 (codified at 20 U.S.C. 1078(c)(1)(A)). That section pro-

vides that state guaranty agencies "shall be deemed to have a contractual right against the United States" during the life of each GSLP loan "to receive reimbursement" according to the provisions of the Higher Education Act of 1965. That argument also lacks merit because no one acquires a property right in legislation. Congress therefore can modify the terms of social welfare programs without providing compensation to parties that lose the benefits they enjoyed under prior law. See *United States R.R. Retirement Bd.* v. *Fritz*, 449 U.S. 166, 177-178 (1980); *Flemming* v. *Nestor*, 363 U.S. 603 (1960). Indeed, in social welfare programs such as the GSLP, it is essential for Congress to have such flexibility in order to be able to accommodate the changing needs of a particular program within budgetary constraints.

Relying on *Lynch* v. *United States*, 292 U.S. 571 (1934), petitioners argue that contracts are a form of property and that Congress cannot breach its reimbursement contracts with them.[16] *Lynch*, however, is inapposite. In that case, this Court held that Congress had not withdrawn jurisdiction from the district courts to consider challenges to a federal law that repealed provisions of the War Risk Insurance Act, which, in turn, authorized payment of death benefits under insurance policies taken out by soldiers before that statute was enacted. This Court observed in dicta that in consideration for the government's obligation to pay benefits, "the insured paid prescribed monthly premiums" and the insurance policies created "vested rights" that could not be nullified by a later statute. 292 U.S. at 576, 577. The Court suggested that result would obtain even though the policies were made subject to

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[16] Petitioners also rely on *Perry* v. *United States*, 294 U.S. 330, 350-351 (1935), but the gold contracts in that case were not similar to the cooperative federal-state program at issue here, and they also did not contain a clause in which the private party agreed to be bound by future changes in the governing legislation.

future legislation, unless Congress had expressly reserved the power to curtail benefits in the future, or was acting under the police power or some other paramount power. *Id.* at 578, 579.

This case is not governed by the principle stated in *Lynch*, for several reasons. To begin with, the life insurance policies in *Lynch* are not comparable to the reimbursement agreements at issue here, which were executed by the state guaranty agencies in connection with a social welfare program designed for the benefit of third parties. Also, petitioners' alleged "contract right" to reimbursement did not vest when petitioners executed their guaranty agreements; any such right was contingent. In addition, the enforcement provision has not annulled that contingent right; it simply follows the terms of the guaranty agreements in withholding reimbursements from petitioners if they do not satisfy their contractual obligation to comply with valid provisions of the Higher Education Act of 1965, such as the transfer requirement. Finally, the 1987 OBRA Amendments did not relieve the federal government of its obligation to reimburse the state guaranty agencies; the purpose of the amendments was to recapture funds held by the agencies in a fiduciary capacity that Congress found were unnecessary to their continued functioning. See *Education Assistance Corp.* v. *Cavazos*, 902 F.2d at 630; *Ohio Student Loan Comm'n* v. *Cavazos*, 900 F.2d at 900-901. Thus, as the court of appeals held, Section 3001 of the 1987 OBRA Amendments did not take from petitioners a vested contract right to reimbursement.

CONCLUSION

The petitions for a writ of certiorari should be denied.
Respectfully submitted.

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